

# EXHIBIT A

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended July 29, 2017  
OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number: 000-25601

**BROCADE** 

**Brocade Communications Systems, Inc.**

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

77-0409517  
(I.R.S. Employer  
Identification No.)

130 Holger Way  
San Jose, CA 95134-1376  
(408) 333-8000

(Address, including zip code, of principal  
executive offices and registrant's telephone  
number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The number of shares outstanding of the registrant's common stock as of August 25, 2017, was 413,816,134 shares.



**BROCADE COMMUNICATIONS SYSTEMS, INC.**

**FORM 10-Q**

**For the Quarter Ended July 29, 2017**

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## Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements regarding future events and future results. All statements other than statements of historical fact are statements that could be deemed forward-looking statements, including, but not limited to, statements regarding future revenue, margins, expenses, tax provisions, tax treatment, earnings, cash flows, benefit obligations, debt repayments, stock repurchases, dividends, or other financial items; any statements of the plans, strategies, and objectives of management for future operations, including planned investments or acquisitions; any statements concerning expected development, performance, success, market conditions, or market share relating to products or services; any statements regarding future economic conditions or performance; any statements regarding pending litigation, including claims or disputes; any statements of expectation or belief; any statements regarding Brocade's pending acquisition by Broadcom Limited or the divestiture of certain portions of Brocade's IP Networking business; and any statements of assumptions underlying any of the foregoing. Words such as "expects," "anticipates," "assumes," "targets," "projects," "intends," "plans," "believes," "seeks," "estimates," "continues," "may," "should," "could," "depend," "will," "contemplate," "predict," "potential," and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are based on current expectations, estimates, forecasts, and projections about the industries in which Brocade operates, and the beliefs and assumptions of management. Readers are cautioned that these forward-looking statements are only predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict, including those identified below, under "Part II—Other Information, Item 1A. Risk Factors" and elsewhere herein. Therefore, actual results may differ materially and adversely from those expressed or implied in any forward-looking statements. Furthermore, Brocade undertakes no obligation to revise or update any forward-looking statements for any reason.

## Additional Information

Brocade and the B-wing symbol are registered trademarks of Brocade Communications Systems, Inc., in the United States and/or in other countries. Other brands, products, or service names mentioned may be trademarks of Brocade or others.

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# PART I — FINANCIAL INFORMATION

## Item 1. Financial Statements

### **BROCADE COMMUNICATIONS SYSTEMS, INC.** **CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS** (Unaudited)

	Three Months Ended		Nine Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
(In thousands, except per share amounts)				
Net revenues:				
Product	\$ 449,549	\$ 490,995	\$ 1,385,273	\$ 1,400,355
Service	99,717	99,726	298,209	287,956
Total net revenues	549,266	590,721	1,683,482	1,688,311
Cost of revenues:				
Product	154,760	188,492	486,153	464,797
Service	43,361	45,330	136,301	127,489
Total cost of revenues	198,121	233,822	622,454	592,286
Gross margin	351,145	356,899	1,061,028	1,096,025
Operating expenses:				
Research and development	117,116	114,996	360,164	297,516
Sales and marketing	153,712	167,983	506,228	468,743
General and administrative	27,614	32,960	92,127	78,180
Settlement with dissenting stockholder of Ruckus Wireless, Inc.	8,528	—	8,528	—
Amortization of intangible assets	5,822	5,498	20,998	7,302
Acquisition, divestiture, and integration costs	13,246	14,868	49,519	20,625
Restructuring charges (benefits)	17,801	—	17,801	(566)
Impairment of equity investments	2,870	—	2,870	—
Loss on sold and held for sale software product lines	24,315	—	24,315	—
Total operating expenses	371,024	336,305	1,082,550	871,800
Income (loss) from operations	(19,879)	20,594	(21,522)	224,225
Interest expense	(15,875)	(13,462)	(47,317)	(33,282)
Interest and other income, net	2,580	1,557	5,136	3,317
Income (loss) before income tax	(33,174)	8,689	(63,703)	194,260
Income tax expense (benefit)	(13,622)	(1,806)	(27,275)	47,034
Net income (loss)	(19,552)	10,495	(36,428)	147,226
Less: Net loss attributable to noncontrolling interest	(46)	—	(274)	—
Net income (loss) attributable to Brocade Communications Systems, Inc.	\$ (19,506)	\$ 10,495	\$ (36,154)	\$ 147,226
Net income (loss) per share—basic attributable to Brocade Communications Systems, Inc. stockholders	\$ (0.05)	\$ 0.02	\$ (0.09)	\$ 0.36
Net income (loss) per share—diluted attributable to Brocade Communications Systems, Inc. stockholders	\$ (0.05)	\$ 0.02	\$ (0.09)	\$ 0.35
Shares used in per share calculation—basic	411,898	426,671	408,494	411,709
Shares used in per share calculation—diluted	411,898	434,416	408,494	419,416
Cash dividends declared per share	\$ 0.055	\$ 0.055	\$ 0.165	\$ 0.145

See accompanying Notes to Condensed Consolidated Financial Statements.

**BROCADE COMMUNICATIONS SYSTEMS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**  
**(Unaudited)**

	Three Months Ended		Nine Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
	(In thousands)			
Net income (loss)	\$ (19,552)	\$ 10,495	\$ (36,428)	\$ 147,226
Other comprehensive income and loss, net of tax:				
Unrealized gains (losses) on cash flow hedges:				
Change in unrealized gains and losses	209	(700)	376	(1,035)
Net gains and losses reclassified into earnings	363	482	799	1,831
Net unrealized gains (losses) on cash flow hedges	572	(218)	1,175	796
Foreign currency translation adjustments	1,972	(1,628)	2,635	(1,760)
Total other comprehensive income (loss)	2,544	(1,846)	3,810	(964)
Total comprehensive income (loss)	(17,008)	8,649	(32,618)	146,262
Less: Net loss attributable to noncontrolling interest	(46)	—	(274)	—
Less: Total other comprehensive income (loss) attributable to noncontrolling interest	40	—	(32)	—
Total comprehensive income (loss) attributable to Brocade Communications Systems, Inc.	<u>\$ (17,002)</u>	<u>\$ 8,649</u>	<u>\$ (32,312)</u>	<u>\$ 146,262</u>

See accompanying Notes to Condensed Consolidated Financial Statements.

**BROCADE COMMUNICATIONS SYSTEMS, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(Unaudited)**

	July 29, 2017	October 29, 2016
	(In thousands, except par value)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 1,179,369	\$ 1,257,075
Accounts receivable, net of allowances for doubtful accounts of \$1,818. and \$1,736 as of July 29, 2017, and October 29, 2016, respectively	291,989	284,344
Inventories	70,511	69,355
Prepaid expenses and other current assets	87,128	62,236
Current assets held for sale	26,279	—
Total current assets	1,655,276	1,673,010
Property and equipment, net	416,181	455,326
Goodwill	2,255,326	2,295,184
Core/developed technology intangible assets, net	193,959	248,938
Other intangible assets, net	159,041	200,840
Non-current deferred tax assets	40,057	12,736
Other assets	41,591	53,777
Total assets	\$ 4,761,431	\$ 4,939,811

**BROCADE COMMUNICATIONS SYSTEMS, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS—Continued**  
(Unaudited)

**LIABILITIES AND STOCKHOLDERS' EQUITY**

Current liabilities:

Accounts payable	\$ 97,074	\$ 128,685
Accrued employee compensation	144,622	154,165
Deferred revenue	198,704	221,940
Current portion of long-term debt	76,725	76,692
Other accrued liabilities	69,517	113,170
Current liabilities held for sale	8,421	—
Total current liabilities	595,063	694,652
Long-term debt, net of current portion	1,457,602	1,502,063
Non-current deferred revenue	85,055	90,051
Non-current income tax liability	92,582	102,100
Other non-current liabilities	4,330	5,370
Total liabilities	2,234,632	2,394,236

Commitments and contingencies (Note 9)

Stockholders' equity:

Brocade stockholders' equity:

Preferred stock, \$0.001 par value, 5,000 shares authorized, no shares issued and outstanding	—	—
Common stock, \$0.001 par value, 800,000 shares authorized:		
Issued and outstanding: 413,745 and 401,748 shares as of July 29, 2017, and October 29, 2016, respectively	414	402
Additional paid-in capital	1,596,008	1,514,730
Accumulated other comprehensive loss	(23,603)	(27,413)
Retained earnings	951,592	1,055,194
Total Brocade stockholders' equity	2,524,411	2,542,913
Noncontrolling interest	2,388	2,662
Total stockholders' equity	2,526,799	2,545,575
Total liabilities and stockholders' equity	\$ 4,761,431	\$ 4,939,811

See accompanying Notes to Condensed Consolidated Financial Statements.

**BROCADE COMMUNICATIONS SYSTEMS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)

	Nine Months Ended	
	July 29, 2017	July 30, 2016
	(In thousands)	
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ (36,428)	\$ 147,226
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Excess tax benefits from stock-based compensation	—	(1,778)
Depreciation and amortization	118,365	80,979
Loss on disposal of property and equipment	3,506	458
Loss on sold and held for sale software product lines	24,315	—
Net gain on sale of investments	—	(122)
Amortization of debt issuance costs and debt discount	15,571	13,493
Provision (recovery) for doubtful accounts receivable and sales allowances	8,914	(1,946)
Non-cash purchase accounting adjustments to inventory	5,853	20,775
Non-cash stock-based compensation expense	94,471	88,805
Impairment of equity investments	2,870	—
Changes in assets and liabilities, net of acquisitions and divestitures:		
Accounts receivable	(16,558)	988
Inventories	(6,044)	5,601
Prepaid expenses and other assets	(16,029)	(9,725)
Deferred tax assets	63	(109)
Accounts payable	(27,370)	5,519
Accrued employee compensation	(56,803)	(57,520)
Deferred revenue	(20,900)	5,359
Other accrued liabilities	(48,799)	(43,874)
Restructuring liabilities	(365)	(1,223)
Net cash provided by operating activities	44,632	252,906
<b>Cash flows from investing activities:</b>		
Purchases of non-marketable equity and debt investments	—	(2,000)
Proceeds from maturities and sale of short-term investments	—	150,323
Purchases of property and equipment	(28,618)	(59,810)
Net cash paid in connection with acquisitions	—	(564,888)
Proceeds from collection of note receivable	250	250
Net proceeds from sale of software product line	31,769	—
Net cash provided by (used in) investing activities	3,401	(476,125)

**BROCADE COMMUNICATIONS SYSTEMS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS—Continued**  
**(Unaudited)**

	Nine Months Ended	
	July 29, 2017	July 30, 2016
	(In thousands)	
<b>Cash flows from financing activities:</b>		
Payment of principal related to the term loan	(60,000)	—
Payment of debt issuance costs	—	(891)
Payment of principal related to capital leases	—	(282)
Payment of accrued merger consideration to dissenting stockholder of Ruckus Wireless, Inc.	(41,280)	—
Common stock repurchases	—	(841,562)
Proceeds from issuance of common stock	41,283	49,195
Payment of cash dividends to stockholders	(67,448)	(61,706)
Proceeds from term loan	—	787,255
Proceeds from noncontrolling interest	—	2,550
Excess tax benefits from stock-based compensation	—	1,778
Net cash used in financing activities	(127,445)	(63,663)
Effect of exchange rate fluctuations on cash and cash equivalents	1,706	(926)
Net decrease in cash and cash equivalents	(77,706)	(287,808)
Cash and cash equivalents, beginning of period	1,257,075	1,440,882
Cash and cash equivalents, end of period	<u>\$ 1,179,369</u>	<u>\$ 1,153,074</u>
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid for interest	<u>\$ 36,454</u>	<u>\$ 24,264</u>
Cash paid for income taxes	<u>\$ 5,306</u>	<u>\$ 46,163</u>
<b>Supplemental schedule of non-cash investing activities:</b>		
Acquisition of a business by the issuance of stock and accrual for an appraisal demand submitted by a dissenting stockholder of that business	<u>\$ —</u>	<u>\$ 623,116</u>

See accompanying Notes to Condensed Consolidated Financial Statements.

**BROCADE COMMUNICATIONS SYSTEMS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**1. Basis of Presentation**

Brocade Communications Systems, Inc. (“Brocade” or the “Company”) has prepared the accompanying Condensed Consolidated Financial Statements pursuant to the rules and regulations of the United States (“U.S.”) Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted pursuant to such rules and regulations. The Company’s Condensed Consolidated Balance Sheet as of October 29, 2016, was derived from the Company’s audited consolidated financial statements, but does not include all disclosures required by U.S. GAAP. These unaudited Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended October 29, 2016.

The accompanying Condensed Consolidated Financial Statements are unaudited but, in the opinion of the Company’s management, reflect all adjustments—including normal recurring adjustments—that management considers necessary for a fair presentation of these Condensed Consolidated Financial Statements. The results for the interim periods presented are not necessarily indicative of the results for the full fiscal year or any other future period.

The Company’s fiscal year is a 52- or 53-week period ending on the last Saturday in October or the first Saturday in November, respectively. As is customary for companies that use the 52/53-week convention, every fifth year is a 53-week year. Fiscal year 2017 is a 52-week fiscal year and fiscal year 2016 was a 52-week fiscal year. The Company’s next 53-week fiscal year will be fiscal year 2019 and its next 14-week quarter will be the second quarter of fiscal year 2019.

The Company’s Condensed Consolidated Financial Statements include the accounts of Brocade and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated. In May 2016, the Company entered into a joint venture agreement with Guiyang High-Tech Industrial Investment Group Co., Ltd. (“HTII”) to create Guizhou Huiling Technology Co., Ltd (“GHTC”). The Company consolidates its investment in GHTC as this is a variable interest entity, and the Company is the primary beneficiary. The noncontrolling interest attributed to GHTC is presented as a separate component from the Company’s equity in the equity section of the Company’s Condensed Consolidated Balance Sheets. HTII’s share of GHTC’s earnings is presented separately in the Company’s Condensed Consolidated Statements of Operations.

*Use of Estimates in Preparation of Condensed Consolidated Financial Statements*

The preparation of the Company’s Condensed Consolidated Financial Statements and related disclosures in conformity with U.S. GAAP requires management to make estimates and judgments that affect the amounts reported in the Company’s Condensed Consolidated Financial Statements and accompanying notes. Estimates are used for, but not limited to, revenue recognition, sales allowances including discounts, returns, and sales programs, allowance for doubtful accounts, stock-based compensation, acquisition purchase price allocations, warranty obligations, inventory valuation and purchase commitments, impairment of goodwill and other indefinite-lived intangible assets, litigation, gain or loss on held for sale assets and liabilities, and income taxes. Actual results may differ materially from these estimates.

*Proposed Acquisition by Broadcom Limited*

On November 2, 2016, the Company entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Broadcom Limited, a limited liability company organized under the laws of the Republic of Singapore (“Broadcom”), Broadcom Corporation, a California corporation and an indirect subsidiary of Broadcom (“Parent”), and Bobcat Merger Sub, Inc., a Delaware corporation and a direct wholly owned subsidiary of Parent (“Merger Sub”), providing for the merger of Merger Sub with and into the Company (the “Merger”), with the Company surviving as a wholly owned subsidiary of Parent. On December 19, 2016, Parent assigned all of its rights under the Merger Agreement to LSI Corporation, a Delaware corporation and an indirect subsidiary of Broadcom.

At the effective time of the Merger, each share of the Company’s common stock that is outstanding immediately prior to such time will be cancelled and converted into the right to receive \$12.75 per share in cash, without interest, less any required tax withholding.

In general, at the effective time of the Merger: (i) all vested in-the-money Brocade stock options will be cashed out; (ii) Broadcom will assume and convert all vested Brocade stock options that are not in-the-money and all unvested Brocade stock options (whether or not in-the-money), unvested restricted stock units and unvested performance stock units, in each case held by continuing employees and service providers; (iii) all unvested in-the-money Brocade stock options and all unvested Brocade restricted stock units and performance stock units held by members of the Brocade Board of Directors or by senior executives who are parties to change of control agreements providing for the acceleration of vesting and who are not continuing employees or service providers will accelerate vesting and be cashed out; and (iv) all other unvested Brocade restricted stock units and performance stock units and all other Brocade stock options will be cancelled in exchange for no consideration.

Consummation of the Merger is subject to certain customary closing conditions, including, without limitation, the absence of certain legal impediments, the expiration or termination of the required waiting periods under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the “HSR Act”), antitrust regulatory approval in the People’s Republic of China, the European Union and Japan, review and clearance by the Committee on Foreign Investment in the United States (“CFIUS”), and approval by the Company’s stockholders. The transaction is not subject to a financing condition.

The Company’s stockholders approved the Merger and related matters at a special meeting of stockholders held on January 26, 2017. No further approval by the Company’s stockholders is required with respect to the Merger.

On November 30, 2016, each of the Company and Broadcom submitted a notification and report form with the U.S. Federal Trade Commission (the “FTC”) and the Antitrust Division of the U.S. Department of Justice under the HSR Act. On July 3, 2017, the FTC accepted a proposed consent order for public comment in connection with the Merger. The FTC subsequently approved a final consent order on August 17, 2017.

On May 12, 2017, the European Commission (the “EC”) announced that it had granted conditional antitrust clearance of the Merger. As part of the EC’s clearance decision, Broadcom has agreed to certain commitments as set forth in that decision, which commitments will be monitored by a trustee. Broadcom has also committed to the EC that it will not close the Merger before the appointment of the monitoring trustee.

On May 26, 2017, the Japan Fair Trade Commission granted antitrust clearance of the Merger.

On July 17, 2017, the Company and Broadcom agreed to withdraw and re-file their joint voluntary notice to CFIUS to allow more time for review and discussion with CFIUS in connection with the Merger.

On August 22, 2017, the Ministry of Commerce of the People’s Republic of China issued a written notice that it had granted conditional approval of the Merger pursuant to the Anti-Monopoly Law of the People’s Republic of China.

Assuming timely satisfaction or waiver of all remaining closing conditions (including review and clearance by CFIUS), Brocade expects that the Merger will be completed during the fourth quarter of fiscal year 2017.

The Merger Agreement contains certain customary termination rights for the Company and Parent. For example, the Merger Agreement provides that if it is terminated under specified circumstances, including, but not limited to, if the Company accepts a superior acquisition proposal or the Company’s Board of Directors changes or withdraws its recommendation of the Merger, the Company would be required to pay Parent a termination fee of \$195.0 million. Effective upon the approval of the Merger and related matters by the Company’s stockholders on January 26, 2017, payment of this termination fee can no longer be triggered.

## **2. Summary of Significant Accounting Policies**

There have been no material changes in the Company’s significant accounting policies for the nine months ended July 29, 2017, as compared to those disclosed in Brocade’s Annual Report on Form 10-K for the fiscal year ended October 29, 2016.

### *New Accounting Pronouncements or Updates Recently Adopted*

In April 2015, the Financial Accounting Standards Board (“FASB”) issued an update to Accounting Standards Codification (“ASC”) 350, *Intangibles—Goodwill and Other—Internal-Use Software: Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement*. This update provides guidance on the accounting for fees paid in a cloud computing arrangement if the arrangement was determined to include a software license. This update will not change U.S. GAAP for a customer’s accounting for service contracts. The Company adopted this update in the first quarter of fiscal year 2017 and has elected to apply this update prospectively. There was no material impact on the Company’s financial position, results of operations, or cash flows.

In December 2016, the FASB issued an update to the Codification, *Technical Corrections and Improvements*. This update includes various amendments to clarify the Codification, correct unintended application of guidance, or make minor improvements to the Codification. This update is not intended to change U.S. GAAP. The Company adopted this update in the first quarter of fiscal year 2017. There was no material impact on the Company's financial position, results of operations, or cash flows.

In January 2017, the FASB issued an update to ASC 350, *Intangibles—Goodwill and Other: Simplifying the Test for Goodwill Impairment*, which simplifies the goodwill impairment process by eliminating Step 2 from the quantitative goodwill impairment test. Under this update, goodwill is only impaired for the amount the net assets of the reporting unit exceeds its fair value. The impairment loss should not exceed the carrying amount of goodwill, including any impact from tax-deductible goodwill. The Company early adopted this update in the second quarter of fiscal year 2017. There was no material impact on the Company's financial position, results of operations, or cash flows.

*Recent Accounting Pronouncements or Updates That Are Not Yet Effective*

In May 2014, the FASB issued ASC 606, *Revenue from Contracts with Customers*, that will supersede virtually all existing revenue guidance. Under this new revenue guidance, an entity is required to recognize revenue upon transfer of promised goods or services to customers, in an amount that reflects the expected consideration received in exchange for those goods or services. As such, an entity will need to use more judgment and make more estimates than under the current guidance. This new revenue guidance should be applied retrospectively either to each prior reporting period presented in the financial statements, or only to the most current reporting period presented in the financial statements with a cumulative effect adjustment recorded in retained earnings. In August 2015, the FASB issued an update to defer the effective date of this new revenue guidance by one year. This new revenue guidance becomes effective and will be adopted by the Company in the first quarter of fiscal year 2019. The Company is currently evaluating the impact of this new revenue guidance on its consolidated financial statements.

In July 2015, the FASB issued an update to ASC 330, *Inventory: Simplifying the Measurement of Inventory*. Under this update, measurement of inventory is based on the lower of cost or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated cost of completion and disposal. This update does not apply to inventory that is measured using last-in, first-out or the retail inventory method. This update should be applied prospectively and will be adopted by the Company in the first quarter of fiscal year 2018. Early adoption is permitted. The Company does not expect the adoption of this update to have a material impact on its consolidated financial statements.

In March 2016, the FASB issued an update to ASC 606, *Revenue from Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*, which clarifies the implementation guidance for principal versus agent considerations. In April 2016, the FASB issued an update to ASC 606, *Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing*, which clarifies the guidance related to identifying performance obligations and accounting for licenses of intellectual property. In May 2016, the FASB issued an update to ASC 606, *Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients*, which clarifies the guidance related to collectibility and non-cash consideration, as well as provides practical expedients for the transition to ASC 606. In December 2016, the FASB issued an update to ASC 606, *Revenue from Contracts with Customers: Technical Corrections and Improvements*, which clarifies and corrects any unintended application of the new revenue guidance. The Company must adopt these updates with the adoption of ASC 606, *Revenue from Contracts with Customers*. The Company is currently evaluating the impact of these updates on its consolidated financial statements.

In January 2016, the FASB issued an update to ASC 825, *Financial Instruments—Overall: Recognition and Measurement of Financial Assets and Financial Liabilities*. This update consists of eight provisions that provide guidance on the accounting for equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. This update should be applied by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption and prospectively for equity investments without readily determinable fair values. This update becomes effective and will be adopted by the Company in the first quarter of fiscal year 2019. Early adoption is permitted for two of the eight provisions. The Company is currently evaluating the impact of this update on its consolidated financial statements and related disclosures.

In February 2016, the FASB issued ASC 842, *Leases*, that will supersede the existing lease guidance, including on-balance sheet recognition of operating leases for lessees. This new lease guidance should be applied using a modified retrospective approach and will be adopted by the Company in the first quarter of fiscal year 2020. Early adoption is permitted. The Company is currently evaluating the impact of this new lease guidance on its consolidated financial statements.

In March 2016, the FASB issued an update to ASC 718, *Compensation—Stock Compensation: Improvements to Employee Share-Based Payment Accounting*. This update simplifies certain aspects of the accounting for share-based payment transactions, including income taxes, forfeiture rates, classification of awards, and classification in the statement of cash flows. This update becomes effective and will be adopted by the Company in the first quarter of fiscal year 2018. Early adoption is permitted. The Company is currently evaluating the impact of this update on its consolidated financial statements.

In June 2016, the FASB issued ASC 326, *Financial Instrument—Credit Losses*, that will supersede the existing methodology for estimating expected credit losses on certain financial instruments. The new impairment methodology eliminates the probable initial recognition threshold and, instead, estimates the expected credit losses in consideration of past events, current conditions, and forecasted information. This update becomes effective in the first quarter of fiscal year 2021. Early adoption is permitted in the first quarter of fiscal year 2020. The Company is currently evaluating the impact of this update on its consolidated financial statements.

In August 2016, the FASB issued an update to ASC 230, *Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments*. This update consists of eight provisions that provide guidance on the classification of certain cash receipts and cash payments. If practicable, this update should be applied using a retrospective transition method to each period presented. For the provisions that are impracticable to apply retrospectively, those provisions may be applied prospectively as of the earliest date practicable. This update becomes effective and will be adopted by the Company in the first quarter of fiscal year 2019. Early adoption is permitted. The Company is currently evaluating the impact of this update on its consolidated financial statements and related disclosures.

In October 2016, the FASB issued an update to ASC 740, *Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory*. This update requires the recognition of current and deferred income taxes for intra-entity transfers of assets other than inventory. This update should be applied using a modified retrospective approach and becomes effective in the first quarter of fiscal year 2019. Early adoption is permitted. The Company is currently evaluating the impact of this update on its consolidated financial statements.

In November 2016, the FASB issued an update to ASC 230, *Statement of Cash Flows: Restricted Cash*. This update requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. This update should be applied using a retrospective transition method and becomes effective in the first quarter of fiscal year 2019. Early adoption is permitted. The Company is currently evaluating the impact of this update on its consolidated financial statements.

In January 2017, the FASB issued an update to ASC 805, *Business Combinations: Clarifying the Definition of a Business*, which clarifies the definition of a business and adds guidance to assist entities with evaluating whether the transactions should be accounted for as acquisitions (or disposals) of assets or businesses. This update should be applied prospectively and becomes effective in the first quarter of fiscal year 2019. Early adoption is permitted. The Company does not expect the adoption of this update to have a material impact on its consolidated financial statements.

In May 2017, the FASB issued an update to ASC 718, *Compensation—Stock Compensation: Scope of Modification Accounting*, which provides guidance about which changes to the terms or conditions of a share-based payment reward require an entity to apply modification accounting. Under this new guidance, an entity should account for the effects of a modification unless the fair value, vesting conditions, and classification as an equity or liability instrument of the modified award are the same as the original award. This update should be applied prospectively and becomes effective in the first quarter of fiscal year 2019. Early adoption is permitted. The Company does not expect the adoption of this update to have a material impact on its consolidated financial statements.

#### *Concentrations*

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash, cash equivalents, and accounts receivable. Cash and cash equivalents are primarily maintained at five major financial institutions. Deposits held with banks may be redeemed upon demand and may exceed the amount of insurance provided on such deposits.

A majority of the Company's accounts receivable balance is derived from U.S. dollar-denominated sales to original equipment manufacturer ("OEM") partners in the computer storage and server industry. As of July 29, 2017, two customers accounted for a combined total of 33% of total accounts receivable (EMC Corporation ("EMC"), which was acquired by Dell, Inc. on September 7, 2016, combined with direct sales to Dell, Inc. (together, "Dell EMC") with 20% and Hewlett Packard Enterprise Company ("HPE") with 13%). As of October 29, 2016, two customers accounted for a combined total of 42% of total accounts receivable (Dell EMC with 29% and HPE with 13%). The Company performs ongoing credit evaluations of its customers and generally does not require collateral on accounts receivable balances. The Company has established reserves for credit losses and sales allowances.

For the three months ended July 29, 2017, three customers individually accounted for 16% (Dell EMC), 11% (HPE), and 10% (International Business Machines Corporation) of the Company's total net revenues for a combined total of 37% of total net revenues. For the three months ended July 30, 2016, two customers individually accounted for 12% (EMC and HPE) of the Company's total net revenues for a combined total of 24% of total net revenues.

The Company currently relies on single and limited sources for multiple key components used in the manufacture of its products. Additionally, the Company relies on multiple contract manufacturers ("CMs") for the production of its products, including Hon Hai Precision Industry Co., Ltd., Accton Technology Corporation, Universal Scientific Industrial (Shanghai) Co., Ltd., Flextronics Telecom Systems Ltd., Cape EMS Manufacturing (M) Sdn. Bhd., and American Portwell Technology, Inc., and has a service repair arrangement with Flex Ltd. Although the Company uses standard parts and components for its products where possible, the Company's CMs currently purchase, on the Company's behalf, several key components used in the manufacture of products from single- or limited-source suppliers. The Company also entered into license agreements with some of its suppliers, including Qualcomm Inc., for technologies and components that are used in its products.

### **3. Acquisitions, Divestitures, and Assets Held for Sale**

#### *Prior Fiscal Year Acquisition*

##### *Acquisition of Ruckus Wireless, Inc. ("Ruckus")*

On May 27, 2016 ("Acquisition Date"), the Company completed its acquisition of Ruckus, a public company incorporated in the state of Delaware, to strengthen its Internet Protocol ("IP") Networking product portfolio by adding Ruckus' wireless products and services to the Company's networking solutions.

Immediately prior to the completion of the acquisition, there were 92.2 million outstanding shares of Ruckus common stock, which included 3.2 million shares of Ruckus common stock owned by a dissenting former Ruckus stockholder who subsequently filed a petition in Delaware Court of Chancery seeking appraisal of the fair value of those shares under Delaware law. During the three months ended July 29, 2017, the Company entered into a settlement agreement with the dissenting former Ruckus stockholder pursuant to which the dissenting former Ruckus stockholder was paid \$51.9 million, representing \$16.22 per share for each of the 3.2 million shares. The settlement amount exceeded the amounts of \$41.3 million and \$2.1 million previously recorded as purchase consideration and interest expense, respectively, by \$8.5 million, which was recorded as a litigation settlement expense. See Note 9, "Commitments and Contingencies," of the Notes to Condensed Consolidated Financial Statements for further discussion.

Based on the \$8.60 per share closing price of the Company's common stock on the Acquisition Date, the total purchase consideration paid or payable was approximately \$1.3 billion.

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In connection with the acquisition of Ruckus, the Company allocated the total purchase consideration to the net assets acquired and liabilities assumed, including identifiable intangible assets, based on their respective fair values at the Acquisition Date. The following table summarizes the final allocation of the total purchase consideration to the fair value of the assets acquired and liabilities assumed (in thousands):

### **Assets acquired:**

Cash and cash equivalents	\$	95,515
Short-term investments		150,257
Accounts receivable, net of allowances for doubtful accounts of \$2,100		41,339
Inventories		64,000
Prepaid expenses and other current assets		5,252
Property and equipment, net		27,060
Identifiable intangible assets		418,000
Other assets		1,697
Total assets acquired		803,120

### **Liabilities assumed:**

Accounts payable		16,375
Accrued employee compensation		17,514
Deferred revenue		14,520
Other accrued liabilities		33,808
Non-current deferred revenue		9,767
Non-current deferred tax liabilities		64,853
Other non-current liabilities		41,033
Total liabilities assumed		197,870
Net assets acquired, excluding goodwill (a)		605,250
Total purchase consideration (b)		1,275,060
Goodwill (b) - (a)	\$	669,810

Goodwill represents the excess of the total purchase consideration over the fair value of the underlying assets acquired and liabilities assumed. Goodwill is attributable to planned growth in new markets and synergies expected to be achieved from the combined operations of the Company and Ruckus. Goodwill of \$350.2 million was assigned to the IP Networking Products reporting unit, and goodwill of \$319.6 million was assigned to the Global Services reporting unit. Goodwill recognized in the acquisition is not deductible for tax purposes.

The fair value of identified intangible assets and their respective useful lives are as follows (in thousands, except for estimated useful life):

	Approximate Fair Value	Estimated Useful Life (In years)
Trade name/trademark	\$ 42,000	11
Customer relationships	118,000	1 - 7
Developed technology	230,000	6 - 7
In-process research and development ("IPR&D") <sup>(i)</sup>	28,000	N/A <sup>(i)</sup>
Total intangible assets	\$ 418,000	

(i) IPR&D will be accounted for as an indefinite-lived intangible asset until the underlying projects are completed or abandoned.

During the second quarter of fiscal year 2017, the Company finalized the purchase price allocation upon obtaining additional information related to the fair value of inventories, property and equipment, identifiable intangible assets, deferred revenue, and deferred tax liabilities. As a result, the Company recorded measurement period adjustments resulting in a net decrease in goodwill of \$3.9 million. During the three months ended July 29, 2017, there were no measurement period adjustments, and during the nine months ended July 29, 2017, the impact of the measurement period adjustments was not material to the Company's Condensed Consolidated Statements of Operations.



*Current Fiscal Year Divestiture and Assets Held for Sale*

During the third quarter of fiscal year 2017, as a result of the Company's evaluation of capital allocation for its products and initiatives, the Company committed to divest certain product lines of its IP Networking business to three unaffiliated buyers. The Company completed the divestiture of its virtual router ("vRouter") product line for \$31.7 million in cash, which resulted in a \$6.7 million loss. The Company signed purchase agreements to divest its virtual application delivery controller ("vADC") product line for \$16.0 million and its virtual evolved packet core ("vEPC") product line for \$1.9 million. Those divestitures were not completed in the third quarter of fiscal year 2017. Consequently, the assets and liabilities associated with the vADC and vEPC divestitures were classified as held for sale on the Condensed Consolidated Balance Sheet as of July 29, 2017 (valued at fair value less costs to sell through the date of sale), which resulted in a \$17.6 million estimated loss related to those two pending divestitures. The pending divestitures were completed during the fourth quarter of fiscal year 2017.

The total \$24.3 million loss on those three divestitures is presented in the Company's Condensed Consolidated Statements of Operations for the three and nine months ended July 29, 2017, as "Loss on sold and held for sale software product lines." The three divestitures are reported in the IP Networking Products reportable segment.

The following table summarizes the net book value adjusted for estimated loss of components of held for sale assets and liabilities (in thousands):

**Assets held for sale:**

Prepaid expenses	\$	180
Property and equipment, net		1,019
Goodwill		12,921
Finite-lived intangible assets, net		12,159
Total current assets held for sale	\$	26,279

**Liabilities held for sale:**

Accrued employee compensation	\$	179
Deferred revenue		8,242
Total current liabilities held for sale	\$	8,421

*Acquisition, Divestiture, and Integration Costs*

The following table summarizes the "Acquisition, divestiture, and integration costs" included on the Company's Condensed Consolidated Statements of Operations (in thousands):

	Three Months Ended		Nine Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Direct acquisition costs associated with the Ruckus acquisition	\$ 1,184	\$ 10,232	\$ 3,454	\$ 15,218
Divestiture costs <sup>(1)</sup>	829	—	1,570	—
Integration costs associated with the Ruckus acquisition	(372)	4,636	3,338	5,407
Broadcom pending acquisition-related costs <sup>(2)</sup>	11,605	—	41,157	—
Total acquisition, divestiture, and integration costs	\$ 13,246	\$ 14,868	\$ 49,519	\$ 20,625

<sup>(1)</sup> These costs relate to the completed divestiture of the Company's vRouter product line and the pending divestitures of the vADC and vEPC product lines.

<sup>(2)</sup> These costs are related to retention compensation for certain of the Company's employees and legal and consulting fees.

#### 4. Goodwill and Intangible Assets

The following table summarizes goodwill activity by reportable segment during the nine months ended July 29, 2017 (in thousands):

	Storage Area Networking ("SAN") Products	IP Networking Products	Global Services	Total
<b>Balance at October 29, 2016</b>				
Goodwill	\$ 176,320	\$ 1,698,641	\$ 549,437	\$ 2,424,398
Accumulated impairment losses	—	(129,214)	—	(129,214)
	176,320	1,569,427	549,437	2,295,184
Purchase accounting adjustments <sup>(1)</sup>	—	70,182	(74,120)	(3,938)
Divestitures and assets held for sale <sup>(2)</sup>	—	(35,920)	—	(35,920)
<b>Balance at July 29, 2017</b>				
Goodwill	176,320	1,732,903	475,317	2,384,540
Accumulated impairment losses	—	(129,214)	—	(129,214)
	\$ 176,320	\$ 1,603,689	\$ 475,317	\$ 2,255,326

- (1) For the measurement period adjustments recorded in connection with the acquisition of Ruckus, see Note 3, "Acquisitions, Divestitures, and Assets Held for Sale," of the Notes to Condensed Consolidated Financial Statements.
- (2) The reduction in goodwill relates to the completed divestiture of the Company's vRouter product line and the pending divestitures of the vADC and vEPC product lines in the third quarter of fiscal year 2017. See Note 3, "Acquisitions, Divestitures, and Assets Held for Sale," of the Notes to Condensed Consolidated Financial Statements for additional information.

The Company conducts its goodwill impairment test annually, as of the first day of the fourth fiscal quarter, and whenever events occur or facts and circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. For the annual goodwill impairment test, the Company uses the income approach, the market approach, or a combination thereof to determine each reporting unit's fair value. The income approach provides an estimate of fair value based on discounted expected future cash flows ("DCF"). The market approach provides an estimate of fair value by applying various observable market-based multiples to the reporting unit's operating results and then applying an appropriate control premium. For the fiscal year 2016 annual goodwill impairment test, the Company used a combination of these approaches to estimate each reporting unit's fair value. At the time that the fiscal year 2016 annual goodwill impairment test was performed, the Company believed that the income approach and the market approach were equally representative of a reporting unit's fair value.

Determining the fair value of a reporting unit requires judgment and involves the use of significant estimates and assumptions. The Company based its fair value estimates on assumptions it believes to be reasonable but are inherently uncertain. Estimates and assumptions with respect to the determination of the fair value of its reporting units using the income approach include, among other inputs:

- The Company's operating forecasts;
- The Company's forecasted revenue growth rates; and
- Risk-commensurate discount rates and costs of capital.

The Company's estimates of revenues and costs are based on historical data, various internal estimates, and a variety of external sources, and are developed as part of the Company's regular long-range planning process. The control premium used in the market approach or as part of combined approaches was determined by considering control premiums offered as part of the acquisitions where acquired companies were comparable with the Company's reporting units.

Based on the results of the annual goodwill impairment analysis performed during the fourth fiscal quarter of 2016, the Company determined that no impairment charge needed to be recorded. As of July 29, 2017, no new events had occurred nor had any facts or circumstances changed since the annual goodwill impairment analysis performed during the fourth quarter of fiscal year 2016 that indicated that the fair values of the reporting units may be less than their current carrying amounts.

Intangible assets other than goodwill are primarily amortized on a straight-line basis over the following estimated remaining useful lives, unless the Company has determined these lives to be indefinite. The Company did not incur costs to renew or extend the term of any acquired finite-lived intangible assets during the nine months ended July 29, 2017.



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The following tables present details of the Company's intangible assets, excluding goodwill (in thousands, except for weighted-average remaining useful life):

July 29, 2017				
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Weighted-Average Remaining Useful Life (In years)
<b>Finite-lived intangible assets:</b>				
Trade names	\$ 42,130	\$ 4,586	\$ 37,544	9.82
Core/developed technology	240,250	46,291	193,959	5.09
Patent portfolio license <sup>(1)</sup>	7,750	2,695	5,055	16.02
Customer relationships	110,000	18,558	91,442	5.83
Total finite-lived intangible assets <sup>(2)</sup>	\$ 400,130	\$ 72,130	\$ 328,000	5.58
<b>Indefinite-lived intangible assets, excluding goodwill:</b>				
IPR&D <sup>(3)</sup>	25,000	—	25,000	
Total indefinite-lived intangible assets, excluding goodwill	25,000	—	25,000	
Total intangible assets, excluding goodwill	\$ 425,130	\$ 72,130	\$ 353,000	

October 29, 2016				
	Gross Carrying Value	Accumulated Amortization	Net Carrying Value	Weighted-Average Remaining Useful Life (In years)
<b>Finite-lived intangible assets:</b>				
Trade names	\$ 45,090	\$ 2,359	\$ 42,731	10.51
Core/developed technology	286,290	37,352	248,938	5.51
Patent portfolio license <sup>(1)</sup>	7,750	1,935	5,815	17.00
Customer relationships	143,110	15,813	127,297	6.32
Non-compete agreements	1,050	983	67	0.29
Patents with broader applications	1,040	110	930	13.38
Total finite-lived intangible assets	\$ 484,330	\$ 58,552	\$ 425,778	6.08
<b>Indefinite-lived intangible assets, excluding goodwill:</b>				
IPR&D <sup>(3)</sup>	24,000	—	24,000	
Total indefinite-lived intangible assets, excluding goodwill	24,000	—	24,000	
Total intangible assets, excluding goodwill	\$ 508,330	\$ 58,552	\$ 449,778	

(1) The patent portfolio license was assigned an estimated useful life that reflects the Company's consumption of the expected defensive benefits related to this license to certain patents. The method of amortization for the patent portfolio license reflects the Company's estimate of the pattern in which these expected defensive benefits will be used by the Company and is primarily based on the mix of expiration patterns of the individual patents included in the license.

(2) During the nine months ended July 29, 2017, \$9.5 million of finite-lived intangible assets became fully amortized and, therefore, were removed from the balance sheet.

(3) Acquired IPR&D is an intangible asset accounted for as an indefinite-lived asset until the completion or abandonment of the associated research and development effort. If the research and development effort associated with the IPR&D is successfully completed, then the IPR&D intangible asset will be amortized over its estimated useful life to be determined at the date the effort is completed.



The Company conducts its IPR&D impairment test annually, as of the first day of the fourth fiscal quarter, and whenever events occur or facts and circumstances indicate that it is more likely than not that the IPR&D is impaired. For the annual IPR&D impairment test, the Company elects the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of the IPR&D asset is less than the carrying amount. If, after assessing the totality of events and circumstances, the Company determines that it is more likely than not that the fair value of the IPR&D asset is less than the carrying amount, then the Company conducts a quantitative analysis to determine the fair value of the IPR&D asset. If the carrying amount of the IPR&D asset exceeds the fair value, then the Company recognizes an impairment loss equal to the difference.

Based on the results of the annual IPR&D impairment analysis performed during the fourth fiscal quarter of 2016, the Company determined that no impairment needed to be recorded. As of July 29, 2017, no new events had occurred nor had any facts or circumstances changed since the annual IPR&D impairment analysis performed during the fourth quarter of fiscal year 2016 that indicated that the fair value of the IPR&D asset may be less than the current carrying amount.

The amortization of finite-lived intangible assets is included in the following line items of the Company's Condensed Consolidated Statements of Operations as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Cost of revenues	\$ 10,612	\$ 8,922	\$ 36,352	\$ 15,269
General and administrative <sup>(1)</sup>	248	271	760	821
Amortization of intangible assets	5,822	5,498	20,998	7,302
Total	<u>\$ 16,682</u>	<u>\$ 14,691</u>	<u>\$ 58,110</u>	<u>\$ 23,392</u>

(1) The amortization is related to the \$7.8 million perpetual, nonexclusive license to certain patents purchased in fiscal year 2015.

The following table presents the estimated future amortization of finite-lived intangible assets as of July 29, 2017 (in thousands):

Fiscal Year	Estimated Future Amortization
2017 (remaining three months)	\$ 14,761
2018	58,961
2019	58,760
2020	58,294
2021	58,225
Thereafter	78,999
Total	<u>\$ 328,000</u>

## 5. Balance Sheet Details

The following tables provide details of selected balance sheet items (in thousands):

	July 29, 2017	October 29, 2016
<b>Inventories:</b>		
Raw materials	\$ 29,032	\$ 17,793
Finished goods	41,479	51,562
Inventories	<u>\$ 70,511</u>	<u>\$ 69,355</u>

	July 29, 2017	October 29, 2016
<b>Property and equipment, net:</b>		
Gross property and equipment		
Computer equipment	\$ 18,356	\$ 19,710
Software	90,040	89,132
Engineering and other equipment	388,787	445,115
Furniture and fixtures	32,990	33,788
Leasehold improvements	36,801	37,973
Land and building	386,163	386,163
Total gross property and equipment	953,137	1,011,881
Accumulated depreciation and amortization <sup>(1)</sup>	(536,956)	(556,555)
Property and equipment, net	\$ 416,181	\$ 455,326

(1) The following table presents the depreciation of property and equipment included on the Company's Condensed Consolidated Statements of Operations (in thousands):

	Three Months Ended		Nine Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Depreciation expense	\$ 19,040	\$ 20,393	\$ 60,255	\$ 57,531

## 6. Fair Value Measurements

The Company applies fair value measurements for both financial and non-financial assets and liabilities. The Company does not have any non-financial assets or liabilities that are required to be measured at fair value on a recurring basis as of July 29, 2017.

The fair value accounting guidance permits companies to elect fair value measurement for many financial instruments and certain other items that are not required to be accounted for at fair value. The Company did not elect fair value measurement for any eligible financial instruments or other assets.

### *Fair Value Hierarchy*

The Company utilizes a fair value hierarchy that maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

During the nine months ended July 29, 2017, the Company had no transfers between levels of the fair value hierarchy of its assets and liabilities measured at fair value.

Assets and liabilities measured and recorded at fair value on a recurring basis as of July 29, 2017, were as follows (in thousands):

		Fair Value Measurements Using		
	Balance as of July 29, 2017	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>				
Money market funds <sup>(1)</sup>	\$ 824,925	\$ 824,925	\$ —	\$ —
Derivative assets	737	—	737	—
Total assets measured at fair value	<u>\$ 825,662</u>	<u>\$ 824,925</u>	<u>\$ 737</u>	<u>\$ —</u>
<b>Liabilities:</b>				
Derivative liabilities	\$ 141	\$ —	\$ 141	\$ —
Total liabilities measured at fair value	<u>\$ 141</u>	<u>\$ —</u>	<u>\$ 141</u>	<u>\$ —</u>

<sup>(1)</sup> Money market funds are reported within “Cash and cash equivalents” on the Company’s Condensed Consolidated Balance Sheets.

Assets and liabilities measured and recorded at fair value on a recurring basis as of October 29, 2016, were as follows (in thousands):

		Fair Value Measurements Using		
	Balance as of October 29, 2016	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Assets:</b>				
Money market funds <sup>(1)</sup>	\$ 914,724	\$ 914,724	\$ —	\$ —
Derivative assets	514	—	514	—
Total assets measured at fair value	<u>\$ 915,238</u>	<u>\$ 914,724</u>	<u>\$ 514</u>	<u>\$ —</u>
<b>Liabilities:</b>				
Derivative liabilities	\$ 354	\$ —	\$ 354	\$ —
Total liabilities measured at fair value	<u>\$ 354</u>	<u>\$ —</u>	<u>\$ 354</u>	<u>\$ —</u>

<sup>(1)</sup> Money market funds are reported within “Cash and cash equivalents” on the Company’s Condensed Consolidated Balance Sheets.

## 7. Restructuring Charges (Benefits)

The following table provides details of “Restructuring charges (benefits)” included in the Company’s Condensed Consolidated Statements of Operations (in thousands):

	Three Months Ended		Nine Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Severance and other employee termination costs related to employee voluntary separation plan	\$ 17,801	\$ —	\$ 17,801	\$ —
Lease loss reserve and related benefits	—	—	—	(566)
Total restructuring charges (benefits)	<u>\$ 17,801</u>	<u>\$ —</u>	<u>\$ 17,801</u>	<u>\$ (566)</u>

*Fiscal 2017 Third Quarter Employee Voluntary Separation Plan*

During the third quarter of fiscal year 2017, the Company implemented a voluntary separation plan for certain eligible employees in the United States and India to reduce the Company's operating expense structure. The voluntary separation plan was approved by the Company's management and communicated to the eligible employees in May 2017. Approximately 230 employees accepted the terms of the voluntary separation plan. As a result, the Company recorded aggregate charges of \$17.8 million for severance and other employee termination costs during the third quarter of fiscal year 2017. The voluntary separation plan was substantially completed in the third quarter of fiscal year 2017. As of July 29, 2017, the cash payments remaining to be made under the plan total \$3.8 million, substantially all of which are expected to be made by the end of the first quarter of fiscal year 2018, and are reported within "Accrued employee compensation" on the Company's Condensed Consolidated Balance Sheets.

**8. Borrowings**

The following table provides details of the Company's long-term debt (in thousands, except years and percentages):

			July 29, 2017		October 29, 2016	
	Maturity	Stated Annual Interest Rate	Amount	Effective Interest Rate	Amount	Effective Interest Rate
<b>Senior Credit Facility:</b>						
Term Loan Facility	2021	variable	\$ 720,000	3.54%	\$ 780,000	2.53%
<b>Convertible Senior Unsecured Notes:</b>						
2020 Convertible Notes	2020	1.375%	575,000	4.98%	575,000	4.98%
<b>Senior Unsecured Notes:</b>						
2023 Notes	2023	4.625%	300,000	4.83%	300,000	4.83%
Total gross long-term debt			1,595,000		1,655,000	
Unamortized discount			(58,405)		(73,540)	
Unamortized debt issuance costs			(2,268)		(2,705)	
Current portion of long-term debt			(76,725)		(76,692)	
Long-term debt, net of current portion			\$ 1,457,602		\$ 1,502,063	

*Senior Credit Facility*

In connection with the acquisition of Ruckus on May 27, 2016, the Company entered into a Credit Agreement (as amended, the "Credit Agreement") with Wells Fargo Bank, N.A., as the administrative agent, swingline lender, and issuing lender, and certain other lenders (collectively, the "Lenders"). The Credit Agreement provides for a term loan facility of \$800.0 million (the "Term Loan Facility") and a revolving credit facility of \$100.0 million (the "Revolving Facility," and together with the Term Loan Facility, the "Senior Credit Facility"). The Revolving Facility includes a \$25.0 million letter of credit subfacility and a \$10.0 million swing line loan subfacility. The proceeds of the Term Loan Facility were used to finance a portion of the acquisition of Ruckus and related fees and expenses, the repurchase of shares of the Company's common stock, and fees and expenses related to the Senior Credit Facility.

Loans made under the Senior Credit Facility bear interest, at the Company's option, either (i) at a base rate which is based in part on the greatest of (A) the prime rate, (B) the federal funds rate plus 0.50%, or (C) LIBOR for an interest period of one month plus 1.00%, plus an applicable margin that will vary between 0.00% and 0.75% based on the Company's total leverage ratio, or (ii) at a LIBOR-based rate, plus an applicable margin that will vary between 1.00% and 1.75% based on the Company's total leverage ratio. For purposes of calculating the applicable rate, the base rate and LIBOR-based rate are subject to a floor of 0.00%. For base rate loans, interest is payable on the last business day of January, April, July, and October of each year. For LIBOR rate loans, interest is payable on the last day of each interest period for the LIBOR-based rate, and if such interest period extends over three months, at the end of each three-month interval during such interest period.

Commitments under the Revolving Facility are subject to an initial commitment fee of 0.30%, and are later subject to adjustment between 0.20% and 0.35% based on the Company's total leverage ratio. Letters of credit issued under the letter of credit subfacility are subject to an initial commission fee starting at 1.50%, and are later subject to adjustment between 1.00% and 1.75% based on the Company's total leverage ratio, and an issuance fee of 0.125%.

The final maturity of the Senior Credit Facility will occur on May 27, 2021, except that if any of the 1.375% convertible senior unsecured notes due 2020 remain outstanding on October 2, 2019, and certain other conditions have not been met, then the final maturity of the Senior Credit Facility will occur on October 2, 2019. Notwithstanding the foregoing, upon the request of the Company made to all applicable Lenders, and provided that no event of default exists or will occur immediately thereafter, individual Lenders may agree to extend the maturity date of its commitments under the Revolving Facility and loans under the Term Loan Facility.

The Company is permitted to make voluntary prepayments of the Senior Credit Facility at any time without payment of a premium or penalty. The Company is required to make mandatory prepayments of loans under the Term Loan Facility (without payment of a premium or penalty) with (i) net cash proceeds from issuances of debt (other than certain permitted debt), (ii) net cash proceeds from certain non-ordinary course asset sales (subject to reinvestment rights and other exceptions), and (iii) casualty proceeds and condemnation awards (subject to reinvestment rights and other exceptions). Commencing October 31, 2016, the loans under the Term Loan Facility will amortize in equal quarterly installments in an aggregate annual amount equal to 10% of the original principal amount thereof, with any remaining balance payable on the final maturity date of the loans under the Term Loan Facility. The loans under the Revolving Facility and all accrued and unpaid interest thereon are due in full on the maturity date.

There were no principal amounts outstanding under the revolving credit facility, and the full \$100.0 million was available for future borrowing under the revolving credit facility as of July 29, 2017. Payments totaling \$60.0 million were made towards the principal of the Term Loan Facility during the nine months ended July 29, 2017.

As of July 29, 2017, and October 29, 2016, the fair value of the Term Loan Facility was approximately \$709.1 million and \$767.4 million, respectively, which was estimated based on fair value for similar instruments.

The obligations under the Senior Credit Facility and certain cash management and hedging obligations are fully and unconditionally guaranteed by certain of the Company's direct and indirect subsidiaries (including Ruckus, but excluding certain immaterial subsidiaries, subsidiaries whose guarantee would result in material adverse tax consequences and subsidiaries whose guarantee is prohibited by applicable law) pursuant to a subsidiary guaranty agreement.

The Company's obligations under the Senior Credit Facility are unsecured, provided that upon the occurrence of certain events (including if the Company's corporate family rating from Moody's falls below Ba1 and from S&P falls below BB+ at any time (referred to as a "Ratings Downgrade")) or the incurrence of certain indebtedness in excess of \$600.0 million (such occurrence or the occurrence of a Ratings Downgrade being a "Collateral Trigger Event"), then such obligations, as well as certain cash management and hedging obligations, will be required to be secured, subject to certain exceptions, by 100% of the equity interests of all present and future restricted subsidiaries directly held by the Company or any guarantor. As of the date hereof, all of the Company's subsidiaries are restricted subsidiaries under the Senior Credit Facility. The Company must provide such security within 90 days (or 20 business days with respect to the equity interests of material U.S. subsidiaries) of such Collateral Trigger Event.

The Credit Agreement contains financial maintenance covenants, including (i) a maximum total leverage ratio as of the last date of any fiscal quarter which, prior to the amendment to the Credit Agreement discussed below, was not to exceed 3.50 to 1, subject to certain step-downs to 3.25 to 1 and 3.00 to 1 for fiscal periods ending on or after April 30, 2017, and April 30, 2018, respectively, and (ii) a minimum interest coverage ratio of not less than 3.50 to 1. The Credit Agreement also contains restrictive covenants that limit, among other things, the Company's and its restricted subsidiaries' ability to:

- Incur additional indebtedness or issue certain preferred equity, pay dividends, or make other distributions or other restricted payments (including stock repurchases);
- Sell assets other than on terms specified by the Credit Agreement;
- Amend the terms of certain other indebtedness and organizational documents;
- Create liens on certain assets to secure debt, consolidate, merge, sell, or otherwise dispose of all or substantially all of their assets; and
- Enter into certain transactions with affiliates, or change their lines of business, fiscal years, and accounting practices, in each case, subject to customary exceptions.

The Credit Agreement also sets forth customary events of default, including upon the failure to make timely payments under the Senior Credit Facility, the failure to satisfy certain covenants, cross-default and cross-acceleration to other material debt for borrowed money, the occurrence of a change of control, and specified events of bankruptcy and insolvency.

As discussed under Note 1, “Basis of Presentation,” of the Notes to Condensed Consolidated Financial Statements, on November 2, 2016, the Company entered into a merger agreement with Broadcom under which Broadcom agreed to acquire Brocade. The consummation of the proposed acquisition by Broadcom would constitute a “change of control” under the events of default under the Credit Agreement. Due primarily to the pendency of the Merger and Broadcom’s stated intent to divest the Company’s IP Networking business after the closing of the Merger, the Company has experienced lower than expected revenue, earnings, and cash flows and higher than expected acquisition and integration expenses. As a result, on August 11, 2017, the Company amended the Credit Agreement, effective for the Company’s third fiscal quarter of 2017, to modify the consolidated total leverage ratio covenant to (i) postpone the effective date of a previously scheduled third fiscal quarter reduction in the maximum permitted consolidated total leverage ratio from 3.50 to 1 to 3.25 to 1 until the Company’s 2018 fiscal year, thus keeping the maximum permitted ratio at 3.50 to 1 for both the Company’s third and fourth fiscal quarters of 2017, and (ii) temporarily suspend the applicability of an existing 15% limit on the amount of certain expenses, including acquisition, integration and restructuring expenses, that may be added back when calculating consolidated EBITDA for purposes of financial covenant compliance for both the Company’s third and fourth fiscal quarters of 2017.

#### *Convertible Senior Unsecured Notes*

On January 14, 2015, the Company issued \$575.0 million in aggregate principal amount of 1.375% convertible senior unsecured notes due 2020 (the “2020 Convertible Notes”) pursuant to an indenture, dated as of January 14, 2015, between the Company and Wells Fargo Bank, National Association, as the trustee (the “Offering”). Net of an original issue discount, the Company received \$565.7 million in proceeds from the Offering. Concurrently with the closing of the Offering, the Company called for redemption its outstanding 6.875% senior secured notes due 2020 (the “2020 Notes”) and irrevocably deposited a portion of the net proceeds from the Offering with the trustee to discharge the indenture governing the 2020 Notes.

The 2020 Convertible Notes bear interest payable semiannually on January 1 and July 1 of each year, beginning on July 1, 2015. No payments were made toward the principal of the 2020 Convertible Notes during the nine months ended July 29, 2017.

The Company separately accounts for the liability and equity components of the 2020 Convertible Notes. The fair value of the liability component, used in the allocation between the liability and equity components as of the date of issuance, was based on the present value of cash flows using a discount rate of 4.57%, the Company’s borrowing rate for a similar debt instrument without the conversion feature. The carrying values of the liability and equity components of the 2020 Convertible Notes are as follows (in thousands):

	July 29, 2017	October 29, 2016
Principal	\$ 575,000	\$ 575,000
Unamortized discount of the liability component	(46,153)	(59,399)
Net carrying amount of liability component	\$ 528,847	\$ 515,601
Carrying amount of equity component	\$ 43,320	\$ 55,374

As of July 29, 2017, and October 29, 2016, the remaining period of amortization for the discount is 2.42 years and 3.17 years, respectively.

The following table presents the amount of interest cost recognized for amortization of the discount and for the contractual interest coupon for the 2020 Convertible Notes for the following periods (in thousands):

	Three Months Ended		Nine Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Amortization of discount	\$ 4,470	\$ 4,254	\$ 13,245	\$ 12,606
Contractual interest coupon	\$ 1,977	\$ 1,977	\$ 5,930	\$ 5,930

As of July 29, 2017, and October 29, 2016, the fair value of the 2020 Convertible Notes was approximately \$581.7 million and \$564.5 million, respectively, which was estimated based on broker trading prices.

The 2020 Convertible Notes mature on January 1, 2020, unless repurchased or converted in accordance with their terms prior to such date. The 2020 Convertible Notes are not callable prior to their maturity. The 2020 Convertible Notes are convertible into common shares of the Company under the circumstances described below. The initial conversion rate is 62.7746 shares of the Company’s common stock per \$1,000 principal amount of the notes, which is equal to 36.1 million shares at an initial conversion price of approximately \$15.93 per share.

The 2020 Convertible Notes contain provisions where the conversion rate is adjusted upon the occurrence of certain events, including if the Company pays a regular, quarterly cash dividend in an amount greater than \$0.035 per share. During the third fiscal quarter of 2017, the Board of Directors of the Company declared and paid a cash dividend in the amount of \$0.055 per share. Accordingly, as of June 8, 2017, the conversion rate was adjusted to a rate of 63.6060 shares of the Company's common stock per \$1,000 principal amount of the notes, which is equal to 36.6 million shares at a conversion price of approximately \$15.72 per share. However, because the adjustment resulted in a change to the conversion rate of less than 1%, as is allowed by the terms of the indenture governing the 2020 Convertible Notes, the Company elected to defer the administration and noteholder notification of such adjustment until the occurrence of (i) a subsequent adjustment to the conversion rate that results in a cumulative adjustment of at least 1% of the current conversion rate, (ii) the conversion of any 2020 Convertible Note, or (iii) certain other events requiring the adjustment to be made under the indenture governing the 2020 Convertible Notes.

Holders of the 2020 Convertible Notes may convert all or a portion of their notes prior to the close of business on the business day immediately preceding September 1, 2019, in multiples of \$1,000 principal amount, only under the following circumstances:

- During any fiscal quarter commencing after the fiscal quarter ending on May 2, 2015 (and only during such fiscal quarter), if the last reported sale price of the Company's common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is greater than or equal to 130% of the conversion price of the notes on each applicable trading day;
- During the five-business-day period after any 10 consecutive trading-day period in which the trading price per \$1,000 principal amount of the notes for each trading day of that 10 consecutive trading-day period was less than 98% of the product of the last reported sale price of the Company's common stock and the conversion rate of the notes on each such trading day; or
- Upon the occurrence of certain corporate events as specified in the terms of the indenture governing the 2020 Convertible Notes.

On or after September 1, 2019, to the close of business on the second scheduled trading day immediately preceding the maturity date, holders may convert all or any portion of their notes regardless of the foregoing conditions.

As of July 29, 2017, the circumstances for conversion had not been triggered, and the 2020 Convertible Notes were not convertible. The if-converted value of the 2020 Convertible Notes as of July 29, 2017, did not exceed the principal amount of the 2020 Convertible Notes.

If a "fundamental change," as specified in the terms of the indenture governing the 2020 Convertible Notes, occurs prior to the maturity date, holders of the notes may require the Company to repurchase the 2020 Convertible Notes at a repurchase price equal to 100% of the principal amount of the 2020 Convertible Notes repurchased, plus accrued and unpaid interest, if any, up to the repurchase date. As of July 29, 2017, a fundamental change had not occurred and the 2020 Convertible Notes were not re-purchasable.

The consummation of the proposed Broadcom acquisition would constitute a "fundamental change" as well as a "make-whole fundamental change" under the terms of the indenture governing the 2020 Convertible Notes. Accordingly, holders of the 2020 Convertible Notes will have the right to require the Company to repurchase their notes upon the consummation of the proposed Broadcom acquisition. In addition, the consummation of the Broadcom acquisition will cause the 2020 Convertible Notes to become convertible for a specified period of time following such consummation, will result in an adjustment to the conversion rate for conversions of the 2020 Convertible Notes during a specified period of time following such consummation, and will require that the Company settle all such conversions in cash.

*Convertible Note Hedge and Warrants Related to the Convertible Senior Unsecured Notes*

In connection with the issuance of the 2020 Convertible Notes, the Company entered into convertible note hedge transactions with certain financial institutions (the “counterparties”) with respect to its common stock. Upon conversion of the 2020 Convertible Notes, the convertible note hedge transactions give the Company the right to acquire from the counterparties, subject to anti-dilution adjustments substantially similar to those in the 2020 Convertible Notes, initially approximately 36.1 million shares of the Company’s common stock at an initial strike price of \$15.93 per share. Because a dividend in an amount greater than \$0.035 per share was declared and paid effective beginning in the third fiscal quarter of 2015, the strike price under the convertible note hedge transactions has been adjusted to approximately \$15.72 per share as of June 8, 2017. The convertible note hedge transactions are expected generally to reduce the potential common stock dilution and/or offset potential cash payments in excess of the principal amount of converted notes upon conversion of the notes in the event that the market price per share of the Company’s common stock, as measured under the terms of the convertible note hedge transactions, is greater than the strike price of the convertible note hedge transactions. The convertible note hedge transactions will be terminated on the maturity date of the 2020 Convertible Notes or earlier under certain circumstances. The \$86.1 million cost of the convertible note hedge transactions has been accounted for as an equity transaction.

Separately from the convertible note hedge transactions, the Company entered into warrant transactions with the counterparties, pursuant to which the Company sold warrants to the counterparties to acquire, subject to customary anti-dilution adjustments, up to 36.1 million shares in the aggregate at an initial strike price of \$20.65 per share. The primary reason the Company entered into these warrant transactions was to partially offset the cost of the convertible note hedge transactions. The warrants mature over 60 trading days, commencing on April 1, 2020, and are exercisable solely on the maturity dates. The warrants are subject to net share settlement; however, the Company may elect to cash settle the warrants. The Company received gross proceeds of \$51.2 million from the warrant transactions, which have been accounted for as an equity transaction.

Under the terms of the warrants, the strike price and number of shares to be acquired by the holders of the warrants are adjusted if the Company pays a regular, quarterly cash dividend in an amount greater than \$0.035 per share. Accordingly, the terms of the warrants were adjusted to reflect the payment of a cash dividend in the amount of \$0.055 per share beginning in the third fiscal quarter of 2016. As of June 8, 2017, the holders of the warrants have the right to acquire up to approximately 36.6 million shares of the Company’s common stock at a strike price of approximately \$20.38 per share.

See Note 15, “Net Income (Loss) per Share,” of the Notes to Condensed Consolidated Financial Statements for further discussion of the dilutive impact of the 2020 Convertible Notes and the convertible note hedge and warrant transactions.

The consummation of the proposed acquisition by Broadcom would result in a termination of the warrant transactions, in which case the Company would be required to settle such transactions in cash. In addition, announcements relating to the proposed transaction may result in adjustments to the terms of the warrant transactions to take into account the economic effect of the proposed transactions, which could result in greater amounts becoming due upon termination or otherwise have a dilutive effect.

*Senior Unsecured Notes*

In January 2013, the Company issued 4.625% senior unsecured notes in the aggregate principal amount of \$300.0 million due 2023 (the “2023 Notes”) pursuant to an indenture, dated as of January 22, 2013 (the “2023 Indenture”), between the Company, certain domestic subsidiaries of the Company that have guaranteed the Company’s obligations under the 2023 Notes, and Wells Fargo Bank, National Association, as the trustee. The guarantees of the 2023 Notes were released upon the termination of the Senior Secured Credit Facility and discharge of the 2020 Indenture in the first fiscal quarter of 2015.

The 2023 Notes bear interest payable semiannually on January 15 and July 15 of each year. No payments were made toward the principal of the 2023 Notes during the nine months ended July 29, 2017.

As of July 29, 2017, and October 29, 2016, the fair value of the 2023 Notes was approximately \$307.9 million and \$297.0 million, respectively, which was estimated based on broker trading prices.

On or after January 15, 2018, the Company may redeem all or part of the 2023 Notes at the redemption prices set forth in the 2023 Indenture, plus accrued and unpaid interest, if any, up to the redemption date. At any time prior to January 15, 2018, the Company may redeem all or a part of the 2023 Notes at a price equal to 100% of the principal amount of the 2023 Notes, plus an applicable premium and accrued and unpaid interest, if any, up to the redemption date.

If the Company experiences a specified change of control triggering event, it must offer to repurchase the 2023 Notes at a repurchase price equal to 101% of the principal amount of the 2023 Notes repurchased, plus accrued and unpaid interest, if any, up to the repurchase date. The consummation of the proposed acquisition by Broadcom could result in a Change of Control Triggering Event if the acquisition is accompanied or followed within a specific period by certain downgrades of the ratings of the 2023 Notes.

The 2023 Indenture contains covenants that, among other things, restrict the ability of the Company and its subsidiaries to:

- Incur certain liens and enter into certain sale-leaseback transactions;
- Create, assume, incur, or guarantee additional indebtedness of the Company's subsidiaries without such subsidiaries guaranteeing the 2023 Notes on a pari passu basis; and
- Enter into certain consolidation or merger transactions, or convey, transfer, or lease all or substantially all of the Company's or its subsidiaries' assets.

These covenants are subject to a number of limitations and exceptions as set forth in the 2023 Indenture. The 2023 Indenture also includes customary events of default, including cross-defaults to other debt of the Company and its subsidiaries.

#### *Debt Maturities*

As of July 29, 2017, the Company's aggregate debt maturities based on outstanding principal were as follows (in thousands):

Fiscal Year	Principal Balances
2017 (remaining three months)	\$ 20,000
2018	80,000
2019	80,000
2020	655,000
2021	460,000
Thereafter	300,000
Total	<u>\$ 1,595,000</u>

## 9. Commitments and Contingencies

#### *Product Warranties*

The Company's accrued liability for estimated future warranty costs is included in "Other accrued liabilities" in the accompanying Condensed Consolidated Balance Sheets. The following table summarizes the activity related to the Company's accrued liability for estimated future warranty costs during the nine months ended July 29, 2017, and July 30, 2016 (in thousands):

	Accrued Warranty	
	Nine Months Ended	
	July 29, 2017	July 30, 2016
Beginning balance	\$ 8,326	\$ 7,599
Warranty liability assumed from acquisitions	—	760
Liabilities accrued for warranties issued during the period	2,136	2,768
Warranty claims paid and used during the period	(2,361)	(2,736)
Changes in liability for pre-existing warranties during the period	838	(60)
Ending balance	<u>\$ 8,939</u>	<u>\$ 8,331</u>

In addition, the Company has defense and indemnification clauses contained within its various customer contracts. As such, the Company indemnifies the parties to whom it sells its products with respect to the Company's products, both alone and in certain circumstances when in combination with other products and services, for infringement of any patents, trademarks, copyrights, or trade secrets, as well as against bodily injury or damage to real or tangible personal property caused by a defective Company product, subject to the particular contract's terms. As of July 29, 2017, there have been no known events or circumstances that have resulted in a material customer contract-related indemnification liability to the Company.

### *Manufacturing and Purchase Commitments*

Brocade has manufacturing arrangements with its CMs under which Brocade provides product forecasts and places purchase orders in advance of the scheduled delivery of products to Brocade's customers. The required lead time for placing orders with the CMs depends on the specific product. Brocade issues purchase orders, and the CMs then generate invoices based on prices and payment terms mutually agreed upon and set forth in those purchase orders. Although the purchase orders Brocade places with its CMs are cancellable, the terms of the agreements require Brocade to purchase all inventory components ordered per Brocade's forecast, which are not returnable, usable by, or sold to other customers of the CMs. In addition, Brocade has an arrangement with one of its CMs regarding factory capacity that can be used by the Company. Under this arrangement, the Company receives a credit for exceeding the planned utilization of factory capacity and, conversely, is required to pay additional fees for underutilizing the planned capacity.

As of July 29, 2017, the Company's aggregate commitment to its CMs for inventory components used in the manufacture of Brocade products was \$158.9 million, which the Company expects to utilize during future normal ongoing operations, net of a purchase commitments reserve of \$1.8 million, which is reported within "Other accrued liabilities" on the Company's Condensed Consolidated Balance Sheet as of July 29, 2017. The Company's purchase commitments reserve reflects the Company's estimate of purchase commitments it does not expect to utilize in normal ongoing operations.

### *Income Taxes*

The Company is subject to several ongoing income tax audits and has received notices of proposed adjustments or assessments from certain tax authorities. For additional discussion, see Note 13, "Income Taxes," of the Notes to Condensed Consolidated Financial Statements. The Company believes it has adequate reserves for all open tax years.

### *Legal Proceedings*

From time to time, the Company is subject to various legal proceedings and claims, including those identified below, which arise in the ordinary course of business, including claims of alleged infringement of patents and/or other intellectual property rights and commercial and employment contract disputes. The Company accrues a liability when management believes that it is both probable that a liability has been incurred and the amount of loss can be reasonably estimated. The Company believes it has recorded adequate provisions for any such matters and, as of July 29, 2017, it was not reasonably possible that a material loss had been incurred in excess of the amounts recognized in the Company's financial statements. However, litigation is inherently uncertain, and the outcome of these matters cannot be predicted with certainty. Accordingly, cash flows or results of operations could be materially affected in any particular period by the resolution of one or more of these matters.

*Ruckus Acquisition-Related Litigation*

A putative class action captioned *Hussey v. Ruckus Wireless, Inc., et al.* is pending in the United States District Court for the Northern District of California (referred to as the “Hussey action”). The original complaint in the Hussey action, filed on June 3, 2016, alleged that Ruckus, members of the Ruckus board of directors, Ruckus’ chief financial officer, Brocade, and a Brocade subsidiary violated Section 14(e) of the Exchange Act based on allegedly false and/or misleading statements and/or alleged omissions in the Solicitation/Recommendation Statement on Schedule 14D-9 filed by Ruckus with the SEC on April 29, 2016, and violated Section 14(d)(7) of the Exchange Act and Rule 14d-10 promulgated thereunder based on the allegedly differential consideration received by members of the Ruckus board of directors and Ruckus’ chief financial officer in connection with the acquisition. An amended complaint, filed on October 24, 2016, named the same defendants as the original complaint and alleged that the defendants violated Sections 14(e), 14(d)(7), and 20(a) of the Exchange Act and Rule 14d-10 promulgated thereunder, that the members of the Ruckus board of directors breached their fiduciary duties to Ruckus stockholders, and that Ruckus’ chief financial officer, Brocade, and the Brocade subsidiary aided and abetted the members of the Ruckus board of directors in breaching their fiduciary duties to Ruckus stockholders. The amended complaint sought an award of damages in an unspecified amount. On December 8, 2016, all defendants filed a motion to dismiss the amended complaint. On February 21, 2017, the court granted the motion and dismissed the amended complaint, with leave to amend as to all claims except the claim for violations of Section 14(d)(7) of the Exchange Act and Rule 14d-10 promulgated thereunder, which claim was dismissed without leave to amend. A second amended complaint was filed on March 27, 2017, adding Ruckus’ financial advisor as an additional defendant and alleging that certain of the defendants violated Sections 14(e) and 20(a) of the Exchange Act, that the members of the Ruckus board of directors and Ruckus’ chief financial officer breached their fiduciary duties to Ruckus stockholders, and that Brocade and the Brocade subsidiary aided and abetted the individual defendants in breaching their fiduciary duties to Ruckus stockholders by purportedly doing one or more of the following: agreeing to terms preferential to the defendants and other Ruckus insiders; accepting overly restrictive deal protection measures in the merger agreement; failing to negotiate for a collar on Brocade’s stock price; providing allegedly false, misleading, and/or incomplete disclosures regarding conflicts of interest and the opinion of Ruckus’ financial advisors; and ultimately agreeing to unfair transaction consideration for the Ruckus shares. The second amended complaint sought an award of damages in an unspecified amount. On April 27, 2017, all defendants filed a motion to dismiss the second amended complaint. On June 29, 2017, the court granted the motion and dismissed the second amended complaint, without leave to amend as to all claims, and entered judgment accordingly. On July 27, 2017, the plaintiffs filed a motion to alter or amend the judgment.

*Ruckus Acquisition-Related Appraisal Demand*

On May 25, 2016, Ruckus received an appraisal demand letter seeking an appraisal under Section 262 of the Delaware General Corporation Law (“Section 262”) of the fair value of 3.2 million Ruckus shares purported to be beneficially owned by Verition Multi-Strategy Master Fund Ltd. (the “Dissenter”) that purportedly dissented from the merger of Ruckus with and into a wholly owned subsidiary of the Company. Under Section 262, the Dissenter is entitled to have those shares appraised by the Delaware Court of Chancery and receive payment of the “fair value” of such shares together with statutory interest as determined by the Delaware Court of Chancery, provided that Dissenter complies with the requirements of Section 262. The Dissenter filed a petition for appraisal in the Delaware Court of Chancery on September 22, 2016, captioned *Verition Multi-Strategy Master Fund Ltd. v. Ruckus Wireless, Inc.* On June 30, 2017, the parties entered into a settlement agreement pursuant to which Ruckus paid the Dissenter \$51.9 million, representing \$16.22 for each of the 3.2 million Ruckus shares in exchange for certain releases and a stipulated dismissal of the appraisal proceeding. On July 12, 2017, the court dismissed the appraisal proceeding.

### *Broadcom Acquisition-Related Litigation*

Subsequent to the announcement that Brocade had agreed to be acquired by Broadcom, six purported class action complaints have been filed on behalf of Brocade's stockholders against Brocade and members of its Board of Directors in the United States District Court for the Northern District of California. Three of the six complaints also name Broadcom Limited, Broadcom Corporation, and/or Bobcat Merger Sub, Inc. as defendants. The six complaints are captioned as follows: Steinberg v. Brocade Communications Systems, Inc., et al. (filed December 12, 2016) (the "Steinberg action"); Gross v. Brocade Communications Systems, Inc., et al. (filed December 15, 2016); Bragan v. Brocade Communications Systems, Inc., et al. (filed December 21, 2016); Jha v. Brocade Communications Systems, Inc., et al. (filed December 21, 2016) (the "Jha action"); Chuakay v. Brocade Communications Systems, Inc., et al. (filed January 5, 2017) (the "Chuakay action"); and Matthew v. Brocade Communications Systems, Inc., et al. (filed January 18, 2017) (collectively, the "Broadcom Acquisition-Related Litigation"). The complaints each allege violations of Sections 14(a) and 20(a) of the Exchange Act and SEC Rule 14a-9 arising out of the Company's preliminary proxy statement filed with the SEC on December 6, 2016 (the "preliminary proxy statement") and/or the Company's definitive proxy statement filed with the SEC on December 20, 2016 (the "definitive proxy statement") relating to Broadcom's proposed acquisition of Brocade. Specifically, the plaintiffs allege that the preliminary proxy statement and/or the definitive proxy statement omits material information regarding the background of the transaction, the Company's financial projections, the Company's intrinsic value and prospects, the valuation analyses performed by Evercore Group L.L.C. ("Evercore"), the Company's financial advisor in connection with the transaction, and alleged conflicts of interest faced by Evercore. The plaintiffs in each action seek to enjoin the defendants from consummating the transaction, or, if the transaction is consummated, the plaintiffs alternatively seek rescission and/or damages. The plaintiffs also seek costs and fees.

On January 11, 2017, the plaintiff in the Jha action filed a motion (the "Injunction Motion") seeking to preliminarily enjoin the special meeting of Brocade stockholders scheduled for January 26, 2017, at which time Brocade stockholders were to vote on the transaction. The plaintiffs in the Steinberg action and the Chuakay action subsequently joined the Injunction Motion. To mitigate the risk of the Broadcom Acquisition-Related Litigation delaying or adversely affecting the transaction, and to minimize the expense of defending the Broadcom Acquisition-Related Litigation, and without admitting any liability or wrongdoing, on January 18, 2017, the Company made certain disclosures that supplemented and revised those contained in the definitive proxy statement. The plaintiffs in the Jha action, the Steinberg action, and the Chuakay action subsequently withdrew the Injunction Motion.

On April 13, 2017, the court consolidated the six actions and named a lead plaintiff.

### **10. Derivative Instruments and Hedging Activities**

In the normal course of business, the Company is exposed to fluctuations in interest rates and the exchange rates associated with foreign currencies. The Company's primary objective for holding derivative financial instruments is to manage foreign currency exchange rate risk. The Company currently does not manage its exposure to credit risk by entering into derivative instruments. However, the Company manages its exposure to credit risk through its investment policies. As part of these investment policies, the Company generally enters into transactions with high-credit quality counterparties and, by policy, limits the amount of credit exposure to any one counterparty based on its analysis of that counterparty's relative credit standing.

The amounts subject to credit risk related to derivative instruments are generally limited to the amounts, if any, by which a counterparty's obligations exceed the Company's obligations with that counterparty.

#### *Foreign Currency Exchange Rate Risk*

A majority of the Company's revenue, expense, and capital purchasing activities are transacted in U.S. dollars. However, the Company is exposed to foreign currency exchange rate risk inherent in conducting business globally in numerous currencies. The Company is primarily exposed to foreign currency fluctuations related to operating expenses denominated in currencies other than the U.S. dollar, of which the most significant to its operations for the nine months ended July 29, 2017, were the British pound, the euro, the Indian rupee, the Chinese yuan, the Singapore dollar, the Japanese yen, the Taiwan new dollar, the Australian dollar, the Canadian dollar, the Israeli shekel, the Swiss franc, and the Hong Kong dollar. The Company has established a foreign currency risk management program to protect against the volatility of future cash flows caused by changes in foreign currency exchange rates. This program reduces, but does not eliminate, the impact of foreign currency exchange rate movements.

The Company utilizes a rolling hedge strategy for the majority of its foreign currency derivative instruments to hedge exposures to the variability in the U.S. dollar equivalent of anticipated non-U.S.-dollar-denominated cash flows. All of the Company's foreign currency forward contracts are single delivery, which are settled at maturity involving one cash payment. The Company's foreign currency risk management program includes foreign currency derivatives with a cash flow hedge accounting designation that utilizes foreign currency forward and option contracts to hedge exposures to the variability in the U.S. dollar equivalent of anticipated non-U.S.-dollar-denominated cash flows. These instruments generally have a maturity of less than 15 months. For these derivatives, the Company initially reports the after-tax gain or loss from the effective portion of the hedge as a component of accumulated other comprehensive loss in stockholders' equity and reclassifies it into earnings in the same period in which the hedged transaction affects earnings. The tax effect allocated to cash flow hedge-related components of other comprehensive income was not significant for the three and nine months ended July 29, 2017, and July 30, 2016.

Ineffective cash flow hedges are included in the Company's net income (loss) as part of "Interest and other income, net." The amount recorded on ineffective cash flow hedges was not significant for the three and nine months ended July 29, 2017, and July 30, 2016.

Net losses relating to the effective portion of foreign currency derivatives, which are offset by net gains on the underlying exposures, are recorded in the Company's Condensed Consolidated Statements of Operations as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Cost of revenues	\$ (80)	\$ (35)	\$ (155)	\$ (195)
Research and development	(24)	(342)	(92)	(968)
Sales and marketing	(269)	(120)	(583)	(764)
General and administrative	(32)	(10)	(62)	(54)
Total	<u>\$ (405)</u>	<u>\$ (507)</u>	<u>\$ (892)</u>	<u>\$ (1,981)</u>

Alternatively, the Company may choose not to hedge the foreign currency risk associated with its foreign currency exposures if the Company believes such exposure acts as a natural foreign currency hedge for other offsetting amounts denominated in the same currency or if the currency is difficult or too expensive to hedge.

As a result of foreign currency fluctuations, the net foreign currency exchange gains and losses recorded as part of "Interest and other income, net" were losses of \$0.2 million and \$1.9 million for the three and nine months ended July 29, 2017, respectively, and losses of \$0.2 million and \$0.8 million for the three and nine months ended July 30, 2016, respectively.

As of July 29, 2017, the Company had gross unrealized loss positions of \$0.1 million and gross unrealized gain positions of \$0.7 million included in "Other accrued liabilities" and "Prepaid expenses and other current assets," respectively.

#### *Volume of Derivative Activity*

All derivatives are designated as hedging instruments as of July 29, 2017, and October 29, 2016. Total gross notional amounts, presented by currency, are as follows (in thousands):

In U.S. dollars	Derivatives Designated as Hedging Instruments	
	July 29, 2017	October 29, 2016
British pound	\$ 10,537	\$ 42,783
Indian rupee	7,588	32,275
Euro	7,247	34,070
Chinese yuan	4,637	19,805
Swiss franc	3,287	14,426
Singapore dollar	3,253	15,057
Japanese yen	2,078	9,944
Australian dollar	1,980	7,876
Total	<u>\$ 40,607</u>	<u>\$ 176,236</u>



## 11. Stock-Based Compensation

Stock-based compensation expense, net of estimated forfeitures, is included in the following line items of the Company's Condensed Consolidated Statements of Operations as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Cost of revenues	\$ 3,233	\$ 5,965	\$ 12,117	\$ 12,400
Research and development	6,340	9,206	25,045	19,805
Sales and marketing	8,503	17,756	35,097	39,886
General and administrative	5,709	11,716	23,329	21,384
Total stock-based compensation expense	\$ 23,785	\$ 44,643	\$ 95,588	\$ 93,475

The following table presents stock-based compensation expense, net of estimated forfeitures, by grant type (in thousands):

	Three Months Ended		Nine Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Stock options	\$ 369	\$ 3,291	\$ 1,665	\$ 4,727
RSUs, including restricted stock units with market conditions	23,416	35,604	76,401	75,986
Employee stock purchase plan ("ESPP") <sup>(1)</sup>	—	5,748	17,522	12,762
Total stock-based compensation expense	\$ 23,785	\$ 44,643	\$ 95,588	\$ 93,475

- (1) The ESPP stock-based compensation expense recognized in the nine months ended July 29, 2017, includes the acceleration of all of the unamortized expense in the first quarter of fiscal year 2017 due to the suspension of the Company's ESPP without concurrent replacement as required under the terms of the merger agreement with Broadcom.

The following table presents the unrecognized compensation expense, net of estimated forfeitures, by grant type and the related weighted-average periods over which this expense is expected to be recognized as of July 29, 2017 (in thousands, except for the weighted-average period):

	Unrecognized Compensation Expense	Weighted-Average Period (In years)
Stock options	\$ 410	0.66
RSUs, including restricted stock units with market conditions	\$ 104,843	1.76

The following table presents details on grants made by the Company for the following periods:

	Nine Months Ended			
	July 29, 2017		July 30, 2016	
	Granted (Shares in thousands)	Weighted-Average Grant Date Fair Value	Granted (Shares in thousands)	Weighted-Average Grant Date Fair Value
Stock options	—	\$ —	1,390	\$ 1.36
RSUs, including stock units with market conditions	4,102	\$ 9.35	17,879	\$ 7.90

The total intrinsic value of stock options exercised for the nine months ended July 29, 2017, and July 30, 2016, was \$15.6 million and \$1.2 million, respectively.

## 12. Stockholders' Equity

### *Dividends*

During the nine months ended July 29, 2017, the Company's Board of Directors declared the following dividends (in thousands, except per share amounts):

Declaration Date	Dividend per Share	Record Date	Total Amount Paid	Payment Date
November 20, 2016	\$ 0.055	December 12, 2016	\$ 22,346	January 4, 2017
February 22, 2017	\$ 0.055	March 10, 2017	\$ 22,434	April 4, 2017
May 24, 2017	\$ 0.055	June 12, 2017	\$ 22,669	July 5, 2017

Future dividends are subject to review and approval on a quarterly basis by the Company's Board of Directors or a committee thereof, and are limited under the terms of the Merger Agreement (as defined in Note 1, "Basis of Presentation," of the Notes to Condensed Consolidated Financial Statements).

### *Convertible Note Hedge and Warrants Related to the Convertible Senior Unsecured Notes*

In connection with the issuance of the 2020 Convertible Notes, the Company entered into convertible note hedge and warrant transactions with certain financial institutions with respect to its common stock. See Note 8, "Borrowings," of the Notes to Condensed Consolidated Financial Statements for further discussion.

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*Accumulated Other Comprehensive Loss*

The components of other comprehensive income (loss) and related tax effects for the three months ended July 29, 2017, and July 30, 2016, are as follows (in thousands):

	Three Months Ended					
	July 29, 2017			July 30, 2016		
	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
Unrealized gains (losses) on cash flow hedges:						
Change in unrealized gains and losses, foreign exchange contracts	\$ 206	\$ 3	\$ 209	\$ (715)	\$ 15	\$ (700)
Net gains and losses reclassified into earnings, foreign exchange contracts <sup>(1)</sup>	405	(42)	363	507	(25)	482
Net unrealized gains (losses) on cash flow hedges	611	(39)	572	(208)	(10)	(218)
Foreign currency translation adjustments	1,972	—	1,972	(1,628)	—	(1,628)
Total other comprehensive income (loss)	\$ 2,583	\$ (39)	\$ 2,544	\$ (1,836)	\$ (10)	\$ (1,846)

The components of other comprehensive income (loss) and related tax effects for the nine months ended July 29, 2017, and July 30, 2016, are as follows (in thousands):

	Nine Months Ended					
	July 29, 2017			July 30, 2016		
	Before-Tax Amount	Tax Expense	Net-of-Tax Amount	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
Unrealized gains (losses) on cash flow hedges:						
Change in unrealized gains and losses, foreign exchange contracts	\$ 408	\$ (32)	\$ 376	\$ (1,056)	\$ 21	\$ (1,035)
Net gains and losses reclassified into earnings, foreign exchange contracts <sup>(1)</sup>	892	(93)	799	1,981	(150)	1,831
Net unrealized gains (losses) on cash flow hedges	1,300	(125)	1,175	925	(129)	796
Foreign currency translation adjustments	2,635	—	2,635	(1,760)	—	(1,760)
Total other comprehensive income (loss)	\$ 3,935	\$ (125)	\$ 3,810	\$ (835)	\$ (129)	\$ (964)

<sup>(1)</sup> For classification of amounts reclassified from accumulated other comprehensive loss into earnings as reported on the Company's Condensed Consolidated Statements of Operations, see Note 10, "Derivative Instruments and Hedging Activities," of the Notes to Condensed Consolidated Financial Statements.

The changes in accumulated other comprehensive loss by component, net of tax, for the nine months ended July 29, 2017, and July 30, 2016, are as follows (in thousands):

	Nine Months Ended					
	July 29, 2017			July 30, 2016		
	Gains (Losses) on Cash Flow Hedges	Foreign Currency Translation Adjustments	Total Accumulated Other Comprehensive Loss	Losses on Cash Flow Hedges	Foreign Currency Translation Adjustments	Total Accumulated Other Comprehensive Loss
Beginning balance	\$ (871)	\$ (26,542)	\$ (27,413)	\$ (1,539)	\$ (23,463)	\$ (25,002)
Change in unrealized gains and losses	376	2,635	3,011	(1,035)	(1,760)	(2,795)
Net gains and losses reclassified into earnings	799	—	799	1,831	—	1,831
Net current-period other comprehensive income (loss)	1,175	2,635	3,810	796	(1,760)	(964)
Ending balance	\$ 304	\$ (23,907)	\$ (23,603)	\$ (743)	\$ (25,223)	\$ (25,966)



### 13. Income Taxes

In general, the Company's provision for income taxes differs from the tax computed at the U.S. federal statutory tax rate due to state taxes, non-U.S. operations being taxed at rates lower than the U.S. federal statutory tax rate, non-deductible stock-based compensation expense, tax credits, and adjustments to unrecognized tax benefits. The non-U.S. operations primarily relate to its European, Asia Pacific, and Japanese subsidiaries.

The Company recorded an income tax benefit for the three and nine months ended July 29, 2017, primarily due to an operating loss before tax for the three months ended July 29, 2017, and an operating loss before tax and a net discrete benefit from reserve releases as a result of reaching settlement on certain transfer pricing issues with the Geneva Tax Administration ("GTA") during the nine months ended July 29, 2017. The Company recorded an income tax benefit for the three months ended July 30, 2016, and an income tax expense for the nine months ended July 30, 2016.

The effective tax rate for the three months ended July 29, 2017, was higher than the U.S. federal statutory tax rate of 35% primarily due to the U.S. pre-tax loss being partially offset by pre-tax income from outside of the United States, which is generally taxed at lower than the 35%, increasing the relative tax benefits compared to the pre-tax consolidated loss.

The effective tax rate for the nine months ended July 29, 2017, was higher than the U.S. federal statutory tax rate of 35% primarily due to the U.S. pre-tax loss being partially offset by pre-tax income from outside of the United States, which is generally taxed at lower than the 35%, increasing the relative tax benefits compared to the pre-tax consolidated loss, and a net discrete benefit as a result of reaching settlement with the GTA.

The Company's total gross unrecognized tax benefits, excluding interest and penalties, were \$189.8 million as of July 29, 2017. If the total gross unrecognized tax benefits as of July 29, 2017, were recognized in the future, approximately \$144.8 million would decrease the Company's tax expense.

The IRS and other tax authorities regularly examine the Company's income tax returns. In December 2016, the Company reached an agreement with the GTA for fiscal years through 2015, with the exception of fiscal year 2014. The timing of tax examinations, as well as the amounts and timing of related settlements, if any, are highly uncertain. Before the end of fiscal year 2017, it is reasonably possible that either certain audits will conclude or the statutes of limitations relating to certain tax examination periods will expire, or both. After the Company reaches settlement with the tax authorities, the Company expects to record a corresponding adjustment to its unrecognized tax benefits. Taking into consideration the inherent uncertainty as to settlement terms, the timing of payments, and the impact of such settlements on other uncertain tax positions, the Company estimates the range of potential decreases in underlying unrecognized tax benefits is between \$0 and \$2 million in the next 12 months.

### 14. Segment Information

Operating segments are defined as components of an enterprise for which separate financial information is available that is evaluated regularly by the Chief Operating Decision Maker ("CODM"), or decision-making group, in deciding how to allocate resources and in assessing performance. Financial decisions and the allocation of resources are based on the information from the Company's internal management reporting system. Currently, the Company's CODM is its Chief Executive Officer.

Brocade is organized into three operating segments, each of which is an individually reportable segment: SAN Products, IP Networking Products, and Global Services. These reportable segments are organized principally by product category.

At this time, the Company does not track its operating expenses by operating segments because management does not consider this information in its measurement of the performance of the operating segments. The Company also does not track all of its assets by operating segments. The majority of the Company's assets as of July 29, 2017, were attributable to its U.S. operations.

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Summarized financial information by reportable segment for the three and nine months ended July 29, 2017, and July 30, 2016, based on the internal management reporting system, is as follows (in thousands):

	SAN Products	IP Networking Products	Global Services	Total
<b>Three months ended July 29, 2017</b>				
Net revenues	\$ 275,872	\$ 173,677	\$ 99,717	\$ 549,266
Cost of revenues	65,498	89,262	43,361	198,121
Gross margin	<u>\$ 210,374</u>	<u>\$ 84,415</u>	<u>\$ 56,356</u>	<u>\$ 351,145</u>
<b>Three months ended July 30, 2016</b>				
Net revenues	\$ 282,114	\$ 208,881	\$ 99,726	\$ 590,721
Cost of revenues	70,630	117,862	45,330	233,822
Gross margin	<u>\$ 211,484</u>	<u>\$ 91,019</u>	<u>\$ 54,396</u>	<u>\$ 356,899</u>
<b>Nine months ended July 29, 2017</b>				
Net revenues	\$ 864,401	\$ 520,872	\$ 298,209	\$ 1,683,482
Cost of revenues	210,445	275,708	136,301	622,454
Gross margin	<u>\$ 653,956</u>	<u>\$ 245,164</u>	<u>\$ 161,908</u>	<u>\$ 1,061,028</u>
<b>Nine months ended July 30, 2016</b>				
Net revenues	\$ 925,799	\$ 474,556	\$ 287,956	\$ 1,688,311
Cost of revenues	223,806	240,991	127,489	592,286
Gross margin	<u>\$ 701,993</u>	<u>\$ 233,565</u>	<u>\$ 160,467</u>	<u>\$ 1,096,025</u>

**15. Net Income (Loss) per Share**

The following table presents the calculation of basic and diluted net income (loss) per share (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
<b>Basic net income (loss) per share</b>				
Net income (loss) attributable to Brocade	\$ (19,506)	\$ 10,495	\$ (36,154)	\$ 147,226
Weighted-average shares used in computing basic net income (loss) per share	411,898	426,671	408,494	411,709
Basic net income (loss) per share—attributable to Brocade stockholders	<u>\$ (0.05)</u>	<u>\$ 0.02</u>	<u>\$ (0.09)</u>	<u>\$ 0.36</u>
<b>Diluted net income (loss) per share</b>				
Net income (loss) attributable to Brocade	\$ (19,506)	\$ 10,495	\$ (36,154)	\$ 147,226
Weighted-average shares used in computing basic net income (loss) per share	411,898	426,671	408,494	411,709
Dilutive potential common shares in the form of stock options	—	1,227	—	1,329
Dilutive potential common shares in the form of other share-based awards	—	6,518	—	6,378
Weighted-average shares used in computing diluted net income (loss) per share	411,898	434,416	408,494	419,416
Diluted net income (loss) per share—attributable to Brocade stockholders	<u>\$ (0.05)</u>	<u>\$ 0.02</u>	<u>\$ (0.09)</u>	<u>\$ 0.35</u>
<b>Antidilutive potential common shares in the form of: <sup>(1)</sup></b>				
Warrants issued in conjunction with the 2020 Convertible Notes <sup>(2)</sup>	36,573	36,316	36,515	36,251
Stock options	1,334	2,838	1,605	2,029
Other share-based awards	8,183	2,120	8,888	1,140

<sup>(1)</sup> These amounts are excluded from the computation of diluted net income (loss) per share.



- (2) In connection with the issuance of the 2020 Convertible Notes, the Company entered into convertible note hedge and warrant transactions as described in Note 8, "Borrowings." The 2020 Convertible Notes have no impact on diluted earnings per share until the average quarterly price of the Company's common stock exceeds the adjusted conversion price of \$15.72 per share. If the common stock price exceeds this adjusted conversion price, then immediately, prior to conversion, the Company will calculate the effect of the additional shares that may be issued using the treasury stock method. If the average price of the Company's common stock exceeds \$20.38 per share for a quarterly period, the Company's weighted-average shares used in computing diluted net income per share will be impacted by the effect of the additional potential shares that may be issued related to the warrants using the treasury stock method. The convertible note hedge is not considered for purposes of the diluted earnings per share calculation, as its effect would be antidilutive.

## 16. Subsequent Event

On August 11, 2017, the Board of Directors of the Company approved a workforce reduction plan intended to facilitate the exit of personnel resources deemed non-essential to the business of the Company due primarily to (i) the divestiture of certain software product lines in the third and fourth quarters of fiscal year 2017 and (ii) an internal realignment of sales resources. The workforce reduction plan impacts approximately 230 notified employees in the United States who are expected to exit the Company during the Company's fourth quarter of fiscal year 2017. The Company expects to incur aggregate charges of approximately \$23 million to \$26 million in its fourth quarter of fiscal year 2017 for severance and other employee termination costs associated with the workforce reduction plan. All of these charges are expected to result in cash expenditures. The Company's headcount as of August 11, 2017, excluding the notified employees and employees associated with the fiscal fourth quarter software divestitures, was approximately 4,600.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

*The following discussion and analysis should be read in conjunction with the Company's Condensed Consolidated Financial Statements and the notes thereto included in Item 1 of this Quarterly Report on Form 10-Q and with Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report filed on Form 10-K with the Securities and Exchange Commission ("SEC") on December 16, 2016. This section and other parts of this Quarterly Report on Form 10-Q contain forward-looking statements that involve risks and uncertainties. Forward-looking statements can also be identified by words such as "expects," "anticipates," "assumes," "targets," "projects," "intends," "plans," "believes," "seeks," "estimates," "continues," "may," "should," "could," "depend," "will," "contemplate," "predict," "potential," and variations of such words and similar expressions. Forward-looking statements are not guarantees of future performance and our actual results may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in the subsection entitled "Risk Factors" below.*

### Overview

We are a leading supplier of networking products and services for businesses and organizations of various types and sizes. Our end customers include global enterprises and other organizations that use our products and services as part of their communications infrastructure. In addition, service providers, such as telecommunication firms, cable operators, and mobile carriers, use our products and services as part of their commercial operations. Our business is focused on two key markets. One is Storage Area Networking ("SAN"), where we offer our SAN products, including modular directors, fixed-configuration and embedded switches, and network management and monitoring capabilities. The second is Internet Protocol ("IP") Networking, where we offer IP routers, Ethernet switches, wireless access points and controllers, as well as network security, analytics, and monitoring. Our IP Networking products are available in multiple form factors and can be deployed in both traditional network and next-generation fabric designs. We provide product-related customer support and services across all our businesses.

Key customer information technology ("IT") initiatives, such as virtualization, enterprise mobility, data center consolidation, cloud computing, and migration to higher performance technologies, such as solid-state storage, continue to rely on our mission-critical SAN-based solutions. We are known as a storage networking innovator and have a leading SAN market share position. Our SAN business strategy is to continue to expand and diversify our partner base and introduce new, innovative solutions for both our large installed base and potential new customers. For example, in fiscal year 2016, we launched our Gen 6 Fibre Channel SAN platform. This next generation of switches and directors delivers superior performance and scalability designed to support demanding workloads from mission-critical applications. In addition, we continue to add new SAN partners and expand relationships with existing partners.

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Our IP Networking business strategies are focused on increasing new customer accounts and expanding our current market share through product innovations, acquisitions, and the development and expansion of our routes to market. Examples include the development of both IP and Ethernet fabric switches, next-generation routers, and the acquisition of Ruckus Wireless, Inc. ("Ruckus"), which was completed on May 27, 2016.

The success of our IP Networking business, in particular, will depend on customers recognizing the benefits of upgrading their data center networks to fabric-based networking architectures and upgrading their wireline and wireless infrastructure at the network edge as part of the overall digital transformation happening in the marketplace. We plan to continue to support our growth strategy with continuous innovation, leveraging the strategic investments we have made in our core businesses, introducing new products, and enhancing our existing partnerships and forming new partnerships through our various distribution channels.

We continuously evaluate the products and initiatives where we choose to allocate capital. As a result of such evaluations, in the third quarter of fiscal year 2017, we completed the divestiture of our virtual router ("vRouter") product line, and entered into agreements to divest our virtual application delivery controller ("vADC") and virtual evolved packet core ("vEPC") product lines (subject to certain closing conditions). Subsequent to the end of the third quarter of fiscal year 2017, we completed the divestitures of our vADC, vEPC, and software-defined networking ("SDN") controller product lines. We do not expect that these divestitures will have a material impact on our financial condition or results of future operations.

We continue to face multiple challenges growing our business as customers consider moving specific workloads to the cloud, evaluate hyper-converged architectures, and assess new architectures based on software, servers, and a mix of proprietary- and commodity-networking hardware. We also continue to be affected by worldwide macroeconomic conditions and face the possibility that these conditions could deteriorate and create a more cautious capital spending environment in the IT sector. In addition, United States ("U.S.") federal customers are important to our business, and spending by the U.S. government can be variable and difficult to predict. We are also cautious about the stability and health of certain international markets and current global and country-specific dynamics, such as the fluctuation in the value of the euro and the Chinese yuan versus the U.S. dollar, slowing economic growth rate in China, Russia-related geopolitical uncertainty, and the planned withdrawal of the United Kingdom from the European Union. These factors may impact our business and those of our partners.

We expect our SAN and IP Networking revenues to fluctuate depending on the demand for our existing and future products and services, and the quality of the sales support for our products and services from our distribution and reseller partners, as well as the timing of product and business transitions by our original equipment manufacturer ("OEM") partners. The average selling prices per port for our SAN and IP Networking products have typically declined over time, unless impacted favorably by a new product introduction or product mix, and we expect this dynamic to continue.

Our plans for our operating cash flows and cash on hand are to provide liquidity for operations, capital investment, and other strategic initiatives, and to return capital to stockholders. In the third quarter of fiscal year 2017, our Board of Directors declared and paid a quarterly cash dividend of \$0.055 per share of our common stock for a total of \$22.7 million. In addition, on August 23, 2017, our Board of Directors declared a quarterly cash dividend of \$0.055 per share of our common stock to be paid on October 3, 2017, to stockholders of record as of the close of market on September 11, 2017. Future dividend payments are subject to review and approval on a quarterly basis by our Board of Directors and are limited under the terms of the Merger Agreement (as defined below).

Due primarily to the impact of the pending acquisition of Brocade by Broadcom Limited ("Broadcom") and the related transactions discussed under "Pending Acquisition by Broadcom Limited" below, we have experienced lower than expected revenue, earnings, and cash flows and higher than expected acquisition, integration, and restructuring expenses. Beginning in the third quarter of fiscal year 2017, we began taking steps to address these impacts, reduce our operating expense structure, and reallocate capital. These efforts have resulted in the following actions:

- The divestiture of four of our software product lines in the third and fourth quarters of fiscal year 2017 as discussed above;
- The implementation of a voluntary separation plan for certain eligible employees in the United States and India in the third quarter of fiscal year 2017 that has resulted in approximately 230 employees exiting Brocade;
- The implementation of an involuntary workforce reduction plan pursuant to which approximately 230 additional employees in the United States are expected to exit Brocade during our fourth quarter of fiscal year 2017; and
- The amendment of our Senior Credit Facility, effective for our third quarter of fiscal year 2017, to postpone the effective date of a previously scheduled third quarter reduction in the maximum permitted consolidated total leverage ratio and to temporarily suspend the applicability of an existing 15% limit on the amount of certain expenses, including acquisition, integration, and restructuring expenses, that may be added back when calculating consolidated EBITDA for purposes of financial covenant compliance.



**Pending Acquisition by Broadcom Limited**

On November 2, 2016, we entered into a merger agreement (the “Merger Agreement”) with Broadcom under which Broadcom agreed to acquire us. Upon closing of the merger, our stockholders will receive \$12.75 in cash, without interest, less any required tax withholding, for each share of our common stock. Our stockholders adopted the Merger Agreement and approved certain related matters at a special meeting of stockholders held on January 26, 2017. Consummation of the merger remains subject to certain other customary closing conditions, including review and clearance by the Committee on Foreign Investment in the United States. The transaction is not subject to a financing condition.

Assuming timely satisfaction or waiver of the necessary closing conditions, we anticipate that the merger will be completed during the fourth quarter of fiscal year 2017. For additional information related to the merger, please refer to the Merger Agreement, which is incorporated herein by reference as Exhibit 2.1 to this Form 10-Q. In addition, on February 22, 2017, Broadcom announced that it had entered into an agreement with ARRIS International plc (“ARRIS”) to divest our wireless and campus business to ARRIS, and on March 29, 2017, Broadcom announced that it had entered into an agreement with Extreme Networks, Inc. (“Extreme Networks”) to divest our data center, switching, routing, and analytics business to Extreme Networks, in each case, contingent on and following Broadcom’s acquisition of Brocade. In addition, as announced on June 27, 2017, we entered into an agreement with Hitachi Data Systems Federal Corporation (“HDS Federal”) to transfer support and services obligations for our U.S. federal cleared contracts to HDS Federal, coincident with Broadcom’s acquisition of Brocade. See Part II, Item 1A. Risk Factors of this Form 10-Q, which is incorporated herein by reference, for a discussion of certain risks due to the announcement and pendency of the proposed acquisition and planned divestitures or the failure of the acquisition to be completed that have had and could continue to have a material adverse effect on our business and operating results. These risks include, but are not limited to, the diversion of management and employee attention, employee attrition, adverse reactions or changes to our business relationships with customers, partners, and suppliers, and uncertainty surrounding our future plans and prospects.

**Overview of Financial Results**

The following table provides an overview of selected financial information (in thousands, except percentages):

	Three Months Ended		Nine Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Total net revenues	\$ 549,266	\$ 590,721	\$ 1,683,482	\$ 1,688,311
Gross margin	\$ 351,145	\$ 356,899	\$ 1,061,028	\$ 1,096,025
Gross margin, as a percentage of total net revenues	63.9 %	60.4%	63.0 %	64.9%
Income (loss) from operations	\$ (19,879)	\$ 20,594	\$ (21,522)	\$ 224,225
Operating income (loss), as a percentage of total net revenues	(3.6)%	3.5%	(1.3)%	13.3%
Net income (loss) attributable to Brocade Communications Systems, Inc.	\$ (19,506)	\$ 10,495	\$ (36,154)	\$ 147,226

## Results of Operations

Our results of operations for the three and nine months ended July 29, 2017, and July 30, 2016, are reported in this discussion and analysis as a percentage of total net revenues, except for gross margin for each reportable segment, which is indicated as a percentage of the respective reportable segment net revenues.

*Revenues.* Our revenues are derived primarily from sales of our SAN and IP Networking products and support and services related to these products, which we call Global Services.

Our total net revenues are summarized as follows (in thousands, except percentages):

	Three Months Ended					
	July 29, 2017		July 30, 2016		Decrease	% Change
	Net Revenues	% of Net Revenues	Net Revenues	% of Net Revenues		
SAN Products	\$ 275,872	50.2%	\$ 282,114	47.7%	\$ (6,242)	(2.2)%
IP Networking Products	173,677	31.6%	208,881	35.4%	(35,204)	(16.9)%
Global Services	99,717	18.2%	99,726	16.9%	(9)	— %
Total net revenues	\$ 549,266	100.0%	\$ 590,721	100.0%	\$ (41,455)	(7.0)%

  

	Nine Months Ended					
	July 29, 2017		July 30, 2016		Increase/(Decrease)	% Change
	Net Revenues	% of Net Revenues	Net Revenues	% of Net Revenues		
SAN Products	\$ 864,401	51.4%	\$ 925,799	54.8%	\$ (61,398)	(6.6)%
IP Networking Products	520,872	30.9%	474,556	28.1%	46,316	9.8 %
Global Services	298,209	17.7%	287,956	17.1%	10,253	3.6 %
Total net revenues	\$ 1,683,482	100.0%	\$ 1,688,311	100.0%	\$ (4,829)	(0.3)%

The decrease in total net revenues for the three months ended July 29, 2017, compared with the three months ended July 30, 2016, reflects lower sales for our SAN products and IP Networking products, as further described below.

- The decrease in SAN product revenues was caused by lower revenues across our SAN product portfolio, primarily due to competition from alternative storage networking technologies and architectures, and customer uncertainty surrounding the pending acquisition by Broadcom. Consequently, the number of ports shipped decreased by 5.0% during the three months ended July 29, 2017, the effect of which was partially offset by a 2.9% increase in the average selling price per port during the same period related to a favorable product mix;
- The decrease in IP Networking product revenues primarily reflects lower wired switch and router revenue due to reduced customer orders following the announcement of Broadcom's planned divestiture of our IP Networking product lines, partially offset by higher wireless revenue for the three months ended July 29, 2017, associated with the May 27, 2016 acquisition of Ruckus. The increase in wireless revenue was primarily due to including only approximately two months of wireless revenue in the prior-year period; and
- The change in Global Services revenues was flat on a percentage basis and the decrease in absolute dollars is immaterial.

The decrease in total net revenues for the nine months ended July 29, 2017, compared with the nine months ended July 30, 2016, reflects lower sales for our SAN products, partially offset by higher sales for our IP Networking products and Global Services offerings, as further described below.

- The decrease in SAN product revenues was caused by lower revenues across our SAN product portfolio, primarily due to competition from alternative storage networking technologies and architectures, and customer uncertainty surrounding the pending acquisition by Broadcom. Consequently, the number of ports shipped decreased by 8.0% during the nine months ended July 29, 2017, the effect of which was partially offset by a 1.5% increase in the average selling price per port during the same period related to a favorable product mix;
- The increase in IP Networking product revenues primarily reflects \$227.7 million in additional revenue from our wireless products associated with the May 27, 2016 acquisition of Ruckus, partially offset by lower wired switch and router revenue due to reduced customer orders following the announcement of Broadcom's planned divestiture of our IP Networking product lines; and



- The increase in Global Services revenues was primarily due to growth in support revenue from our wireless products associated with our acquisition of Ruckus.

Our total net revenues by geographic area are summarized as follows (in thousands, except percentages):

	Three Months Ended					
	July 29, 2017		July 30, 2016		Increase/(Decrease)	% Change
	Net Revenues	% of Net Revenues	Net Revenues	% of Net Revenues		
U.S.	\$ 283,443	51.6%	\$ 339,460	57.4%	\$ (56,017)	(16.5)%
Europe, the Middle East and Africa <sup>(1)</sup>	167,524	30.5%	122,371	20.7%	45,153	36.9 %
Asia Pacific	69,300	12.6%	91,967	15.6%	(22,667)	(24.6)%
Japan	18,983	3.5%	25,315	4.3%	(6,332)	(25.0)%
Canada, Central and South America	10,016	1.8%	11,608	2.0%	(1,592)	(13.7)%
Total net revenues	\$ 549,266	100.0%	\$ 590,721	100.0%	\$ (41,455)	(7.0)%

- (1) Includes net revenues of \$75.9 million and \$59.3 million for the three months ended July 29, 2017, and the three months ended July 30, 2016, respectively, relating to the Netherlands.

	Nine Months Ended					
	July 29, 2017		July 30, 2016		Increase/(Decrease)	% Change
	Net Revenues	% of Net Revenues	Net Revenues	% of Net Revenues		
U.S.	\$ 830,409	49.3%	\$ 920,137	54.5%	\$ (89,728)	(9.8)%
Europe, the Middle East and Africa <sup>(1)</sup>	534,540	31.8%	436,409	25.8%	98,131	22.5 %
Asia Pacific	229,388	13.6%	222,978	13.2%	6,410	2.9 %
Japan	58,685	3.5%	75,546	4.5%	(16,861)	(22.3)%
Canada, Central and South America	30,460	1.8%	33,241	2.0%	(2,781)	(8.4)%
Total net revenues	\$ 1,683,482	100.0%	\$ 1,688,311	100.0%	\$ (4,829)	(0.3)%

- (1) Includes net revenues of \$253.1 million and \$260.8 million for the nine months ended July 29, 2017, and the nine months ended July 30, 2016, respectively, relating to the Netherlands.

Revenues are generally attributed to geographic areas based on where our products are shipped. However, certain OEM partners take possession of our products domestically and then distribute these products to their international customers. We cannot be certain of the extent to which our domestic and international revenue mix is impacted by the logistics practices of our OEM partners. Unless we receive discrete shipment information from our OEM partners, we account for all domestically delivered OEM shipments as domestic revenue. Therefore, international revenues may comprise a larger percentage of our total net revenues than the attributed revenues above indicate.

International revenues for the three months ended July 29, 2017, increased to 48.4% as a percentage of total net revenues compared with 42.5% for the three months ended July 30, 2016, primarily due to a shift in the mix of OEM customer delivery locations for our SAN products. International revenues for the nine months ended July 29, 2017, increased to 50.7% as a percentage of total net revenues compared with 45.5% for the nine months ended July 30, 2016.

A significant portion of our revenues is concentrated among a relatively small number of OEM customers. For the three months ended July 29, 2017, three customers accounted for a combined total of 37% of total net revenues (EMC Corporation ("EMC"), which was acquired by Dell, Inc., combined with direct sales to Dell, Inc. (together, "Dell EMC") with 16%, Hewlett Packard Enterprise Company ("HPE") with 11%, and International Business Machines Corporation ("IBM") with 10%). For the three months ended July 30, 2016, two customers accounted for a combined total of 24% of total net revenues (EMC with 12% and IBM with 12%). For the nine months ended July 29, 2017, one customer (Dell EMC) individually accounted for 16% of our total net revenues. For the nine months ended July 30, 2016, three customers accounted for a combined total of 38% of total net revenues (EMC with 17%, IBM with 11%, and HP with 10%). We expect that a significant portion of our future revenues will continue to come from sales of products to a

relatively small number of OEM customers and to the U.S. federal government and its individual agencies through our distributors and resellers. Therefore, the loss of, or significant decrease in the level of sales to, or a change in the ordering pattern of any one of these customers could seriously harm our financial condition and results of operations.

*Gross margin.* Gross margin as stated below is indicated as a percentage of the respective reportable segment net revenues, except for total gross margin, which is stated as a percentage of total net revenues.

Gross margin is summarized as follows (in thousands, except percentages).

	Three Months Ended					
	July 29, 2017		July 30, 2016		Increase/(Decrease)	% Points Change
	Gross Margin	% of Net Revenues	Gross Margin	% of Net Revenues		
SAN Products	\$ 210,374	76.3%	\$ 211,484	75.0%	\$ (1,110)	1.3%
IP Networking Products	84,415	48.6%	91,019	43.6%	(6,604)	5.0%
Global Services	56,356	56.5%	54,396	54.5%	1,960	2.0%
Total gross margin	<u>\$ 351,145</u>	<u>63.9%</u>	<u>\$ 356,899</u>	<u>60.4%</u>	<u>\$ (5,754)</u>	<u>3.5%</u>

  

	Nine Months Ended					
	July 29, 2017		July 30, 2016		Increase/(Decrease)	% Points Change
	Gross Margin	% of Net Revenues	Gross Margin	% of Net Revenues		
SAN Products	\$ 653,956	75.7%	\$ 701,993	75.8%	\$ (48,037)	(0.1)%
IP Networking Products	245,164	47.1%	233,565	49.2%	11,599	(2.1)%
Global Services	161,908	54.3%	160,467	55.7%	1,441	(1.4)%
Total gross margin	<u>\$ 1,061,028</u>	<u>63.0%</u>	<u>\$ 1,096,025</u>	<u>64.9%</u>	<u>\$ (34,997)</u>	<u>(1.9)%</u>

The changes in gross margin percentage for each reportable segment for the three months ended July 29, 2017, compared with the three months ended July 30, 2016, were primarily due to the following factors:

- SAN gross margins relative to net revenues increased primarily due to lower component and order fulfillment costs and a decrease in overhead costs from lower personnel-related expenses;
- IP Networking gross margins relative to net revenues increased primarily due to a decrease in the purchase accounting adjustment recognized in connection with the fair valuation of inventory acquired from Ruckus and lower excess and obsolete charges for the data center and campus switching business product lines. This was partially offset by higher amortization of IP Networking-related intangible assets, increased manufacturing costs combined with decreased cost absorption on lower revenue, and unfavorable pricing; and
- Global Services gross margins relative to net revenues increased primarily due to lower personnel-related expenses and a decrease in stock-based compensation expense primarily due to a decrease in restricted stock units ("RSUs") granted in the current fiscal year, as well as the suspension of our employee stock purchase plan ("ESPP") in the first quarter of fiscal year 2017 without concurrent replacement as required under the terms of the Broadcom Merger Agreement.

The changes in gross margin percentage for each reportable segment for the nine months ended July 29, 2017, compared with the nine months ended July 30, 2016, were primarily due to the following factors:

- SAN gross margins relative to net revenues were flat on a percentage basis and decreased in absolute dollars primarily due to decreased cost absorption based on lower revenue;
- IP Networking gross margins relative to net revenues decreased primarily due to higher amortization of IP Networking-related intangible assets and increased overhead costs primarily due to growth in personnel-related expenses as a result of the Ruckus acquisition. This was partially offset by increased cost absorption based on higher revenue, a decrease in recognition of the purchase accounting adjustment in connection with the fair valuation of inventory acquired from Ruckus, higher product margins attributable to the acquired wireless products, and lower direct product costs; and
- Global Services gross margins relative to net revenues decreased primarily due to lower support revenue on our SAN products and higher amortization of Global Services-related intangible assets.

*Research and development expenses.* Research and development (“R&D”) expenses consist primarily of compensation and related expenses for personnel engaged in engineering and R&D activities, fees paid to consultants and outside service providers, engineering expenses, which primarily consist of non-recurring engineering charges and prototyping expenses related to the design, development, testing, and enhancement of our products, depreciation related to engineering and test equipment, and allocated expenses related to legal, IT, facilities, and other shared functions.

R&D expenses are summarized as follows (in thousands, except percentages):

R&D expenses:	July 29, 2017		July 30, 2016		Increase	% Change
	Expense	% of Net Revenues	Expense	% of Net Revenues		
Three months ended	\$ 117,116	21.3%	\$ 114,996	19.5%	\$ 2,120	1.8%
Nine months ended	\$ 360,164	21.4%	\$ 297,516	17.6%	\$ 62,648	21.1%

R&D expenses increased for the three months ended July 29, 2017, compared with the three months ended July 30, 2016, primarily due to the following (in thousands):

	Increase/(Decrease)
Equipment expense	\$ 2,697
Outside services expense	1,665
Various individually insignificant items	624
Stock-based compensation expense	(2,866)
Total change	\$ 2,120

Equipment expense increased primarily due to the scrapping of assets no longer needed by the company and increased expenditures following the acquisition of Ruckus. Outside services expense increased primarily due to the recognition of a full quarter’s worth of Ruckus expenses in the current-year period compared to the recognition of a partial quarter’s worth of those expenses in the prior-year period and the increased use of contract workers. Stock-based compensation expense decreased primarily due to a comparatively larger volume of stock option and RSU grants in the third fiscal quarter of 2016 in connection with the Ruckus acquisition. In addition, there was no ESPP-related stock-based compensation expense recognized in the three months ended July 29, 2017, due to the suspension of our ESPP without concurrent replacement in the first quarter of fiscal year 2017 as required under the terms of the Broadcom Merger Agreement.

R&D expenses increased for the nine months ended July 29, 2017, compared with the nine months ended July 30, 2016, primarily due to the following (in thousands):

	Increase
Salaries and other compensation expense	\$ 42,007
Expenses related to legal, IT, facilities, and other shared functions	7,305
Outside services expense	6,874
Stock-based compensation expense	5,240
Various individually insignificant items	1,222
Total change	\$ 62,648

Salaries and other compensation expense increased primarily due to growth in personnel-related expenses as a result of the Ruckus acquisition. Expenses related to legal, IT, facilities, and other shared functions increased primarily due to higher overall costs related to the Ruckus acquisition. Outside services expense increased primarily due to nine months’ worth of Ruckus expenses being recognized in the current-year period compared to only a partial quarter’s worth of expenses being recognized in the prior-year period. Stock-based compensation expense increased primarily due to the recognition of additional Ruckus-related stock-based compensation expense following the acquisition of Ruckus and due to the estimated forfeiture rates used in fiscal year 2017 being lower than in fiscal year 2016. In addition, the suspension of our ESPP without concurrent replacement in the first quarter of fiscal year 2017 as required under the Broadcom Merger Agreement resulted in increased ESPP-related stock-based compensation expense due to all unamortized expense being accelerated and recognized in that quarter.



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*Sales and marketing expenses.* Sales and marketing (“S&M”) expenses consist primarily of salaries, commissions, and related expenses for personnel engaged in sales and marketing functions, costs associated with promotional and marketing programs, travel and entertainment expenses, and allocated expenses related to legal, IT, facilities, and other shared functions.

S&M expenses are summarized as follows (in thousands, except percentages):

	July 29, 2017		July 30, 2016		Increase/(Decrease)	% Change
	Expense	% of Net Revenues	Expense	% of Net Revenues		
S&M expenses:						
Three months ended	\$ 153,712	28.0%	\$ 167,983	28.4%	\$ (14,271)	(8.5)%
Nine months ended	\$ 506,228	30.1%	\$ 468,743	27.8%	\$ 37,485	8.0 %

S&M expenses decreased for the three months ended July 29, 2017, compared with the three months ended July 30, 2016, primarily due to the following (in thousands):

	Increase/(Decrease)
Stock-based compensation expense	\$ (9,253)
Outside services and other marketing expense	(6,171)
Salaries and other compensation expense	2,278
Various individually insignificant items	(1,125)
Total change	\$ (14,271)

Stock-based compensation expense decreased primarily due to a comparatively larger volume of stock option and RSU grants in the third quarter of fiscal year 2016 in connection with the Ruckus acquisition, as well as a lower volume of RSU grants being made in the current-year period due to our pending acquisition by Broadcom. In addition, the suspension of our ESPP without concurrent replacement in the first quarter of fiscal year 2017 as required under the Broadcom Merger Agreement resulted in increased ESPP-related stock-based compensation expense due to all unamortized expense being accelerated and recognized in that quarter. Outside services and other marketing expense decreased primarily due to lower travel expense, as well as decreased consulting, sales event management, marketing, and advertising expense, partially offset by higher spending on other demand generation programs. Salaries and other compensation expense increased primarily due to growth in personnel-related expenses as a result of the Ruckus acquisition, annual merit-based increases in salaries, higher variable incentive compensation, and new retention-focused compensation plans related to our pending acquisition by Broadcom.

S&M expenses increased for the nine months ended July 29, 2017, compared with the nine months ended July 30, 2016, primarily due to the following (in thousands):

	Increase/(Decrease)
Salaries and other compensation expense	\$ 53,393
Expenses related to legal, IT, facilities, and other shared functions	3,503
Outside services and other marketing expense	(14,497)
Stock-based compensation expense	(4,790)
Various individually insignificant items	(124)
Total change	\$ 37,485

Salaries and other compensation expense increased primarily due to higher commission payouts and growth in personnel-related expenses as a result of the Ruckus acquisition. Expenses related to legal, IT, facilities, and other shared functions allocated to S&M activities increased primarily due to higher overall costs related to the Ruckus acquisition. Outside services and other marketing expense decreased primarily due to lower travel expense, as well as decreased consulting, sales event management, marketing, and advertising expense, partially offset by increased expenses related to the Ruckus acquisition. Stock-based compensation expense decreased primarily due to a comparatively larger volume of stock option and RSU grants in the third fiscal quarter of 2016 in connection with the Ruckus acquisition, as well as a lower volume of RSU grants being made in the current-year period due to our pending acquisition by Broadcom. The decrease in stock-based compensation expense was partially offset by an increase in ESPP-related stock-based compensation expense primarily due to the suspension of our ESPP without concurrent replacement in the first quarter of fiscal year 2017 as required under the Broadcom Merger Agreement, which resulted in increased ESPP-related stock-based compensation expense due to all unamortized expense being accelerated and recognized in that quarter.



*General and administrative expenses.* General and administrative (“G&A”) expenses consist primarily of compensation and related expenses for corporate management, finance and accounting, human resources, legal, IT, facilities, and investor relations, as well as recruiting expenses, professional fees, and other corporate expenses, less certain expenses allocated to cost of revenue, R&D, and sales and marketing.

G&A expenses are summarized as follows (in thousands, except percentages):

	July 29, 2017		July 30, 2016		Increase/(Decrease)	% Change
	Expense	% of Net Revenues	Expense	% of Net Revenues		
G&A expenses:						
Three months ended	\$ 27,614	5.0%	\$ 32,960	5.6%	\$ (5,346)	(16.2)%
Nine months ended	\$ 92,127	5.5%	\$ 78,180	4.6%	\$ 13,947	17.8 %

G&A expenses decreased for the three months ended July 29, 2017, compared with the three months ended July 30, 2016, primarily due to the following (in thousands):

	Increase/(Decrease)
Stock-based compensation expense	\$ (6,008)
Outside services expense	(971)
Salaries and other compensation expense	600
Various individually insignificant items	1,033
Total change	\$ (5,346)

Stock-based compensation expense decreased primarily due to higher stock-based compensation expense being recorded in the third fiscal quarter of 2016 in connection with the Ruckus acquisition. In addition, there was no ESPP-related stock-based compensation expense recognized in the three months ended July 29, 2017, due to the suspension of our ESPP without concurrent replacement in the first quarter of fiscal year 2017 as required under the terms of the Broadcom Merger Agreement. Outside services expense decreased primarily due to decreased consulting services. Salaries and other compensation expense increased primarily due to severance payments in connection with the planned departure of certain former Ruckus executives, partially offset by a decrease in variable incentive compensation.

G&A expenses increased for the nine months ended July 29, 2017, compared with the nine months ended July 30, 2016, primarily due to the following (in thousands):

	Increase
Salaries and other compensation expense	\$ 8,439
Outside services expense	2,097
Stock-based compensation expense	1,945
Various individually insignificant items	1,466
Total change	\$ 13,947

Salaries and other compensation expense increased primarily due to growth in personnel-related expenses as a result of the Ruckus acquisition. Outside services expense increased primarily due to an increase in audit fees mainly related to the acquisition of Ruckus, and increased use of contract workers and tax and consulting services. Stock-based compensation expense increased primarily due to higher grant-date fair value of restricted stock units with market conditions granted to executives in the first quarter of fiscal year 2017, the recognition of Ruckus-related stock-based compensation expense in connection with the Ruckus acquisition, and the estimated forfeiture rates used in fiscal year 2017 being lower than in fiscal year 2016. In addition, the suspension of our ESPP without concurrent replacement in the first quarter of fiscal year 2017 as required under the Broadcom Merger Agreement resulted in increased ESPP-related stock-based compensation expense due to all unamortized expense being accelerated and recognized in that quarter.

*Settlement with dissenting stockholder of Ruckus Wireless, Inc.* In the three and nine months ended July 29, 2017, we incurred \$8.5 million in additional expense as part of a settlement with a dissenting Ruckus stockholder. We did not incur any such charges for the three and nine months ended July 30, 2016.

*Amortization of intangible assets.* Amortization of intangible assets is summarized as follows (in thousands, except percentages):

	July 29, 2017		July 30, 2016		Increase	% Change
	Expense	% of Net Revenues	Expense	% of Net Revenues		
Amortization of intangible assets:						
Three months ended	\$ 5,822	1.1%	\$ 5,498	0.9%	\$ 324	5.9%
Nine months ended	\$ 20,998	1.2%	\$ 7,302	0.4%	\$ 13,696	187.6%

The increase in amortization of intangible assets for the three and nine months ended July 29, 2017, compared with the three and nine months ended July 30, 2016, was primarily due to the addition of intangible assets in connection with our acquisition of Ruckus in the third quarter of fiscal year 2016. The increase was partially offset by the decrease in amortization in connection with the intangible assets under our completed and pending divestitures during the three months ended July 29, 2017, as well as due to the completion of amortization of certain intangible assets acquired in connection with our acquisitions of Vyatta, Inc., Connectem Inc., and Ruckus during the nine months ended July 29, 2017 (see Note 4, "Goodwill and Intangible Assets," of the Notes to Condensed Consolidated Financial Statements).

*Acquisition, divestiture, and integration costs.* Acquisition, divestiture, and integration costs are summarized as follows (in thousands, except percentages):

	July 29, 2017		July 30, 2016		Increase/(Decrease)	% Change
	Expense	% of Net Revenues	Expense	% of Net Revenues		
Acquisition, divestiture, and integration costs:						
Three months ended	\$ 13,246	2.4%	\$ 14,868	2.5%	\$ (1,622)	(10.9)%
Nine months ended	\$ 49,519	2.9%	\$ 20,625	1.2%	\$ 28,894	140.1 %

The decrease in acquisition, divestiture, and integration costs for the three months ended July 29, 2017, compared with the three months ended July 30, 2016, was primarily due to decreased consulting services and other professional fees incurred in connection with the Ruckus acquisition, partially offset by retention compensation for certain of our employees and legal fees relating to our pending acquisition by Broadcom (see Note 1, "Basis of Presentation," and Note 3, "Acquisitions, Divestitures, and Assets Held for Sale," of the Notes to Condensed Consolidated Financial Statements).

The increase in acquisition, divestiture, and integration costs for the nine months ended July 29, 2017, compared with the nine months ended July 30, 2016, was primarily due to retention compensation for certain of our employees and legal fees relating to our pending acquisition by Broadcom, partially offset by a decrease in consulting services and other professional fees incurred in connection with the Ruckus acquisition.

*Restructuring charges (benefits).* We incurred \$17.8 million in severance and other employee termination costs for the three and nine months ended July 29, 2017, relating to our employee voluntary separation plan implemented in the third quarter of fiscal year 2017. We did not incur any restructuring charges or benefits for the three months ended July 30, 2016. Restructuring benefits for the nine months ended July 30, 2016, were primarily due to a favorable change in lease terms for a certain facility.

*Impairment of equity investments.* We incurred \$2.9 million in charges relating to the impairment of equity investments for the three and nine months ended July 29, 2017, to reflect updated fair value estimates for our equity investments. We did not incur any such charges for the three and nine months ended July 30, 2016.

*Loss on sold and held for sale software product lines.* We recorded a \$24.3 million charge related to the loss on sold and held for sale software product lines for the three and nine months ended July 29, 2017 (see Note 3, "Acquisitions, Divestitures, and Assets Held for Sale," of the Notes to Condensed Consolidated Financial Statements). We did not incur any such charges for the three and nine months ended July 30, 2016.

*Interest expense.* Interest expense primarily represents the interest cost associated with our senior secured notes, senior unsecured notes, convertible senior unsecured notes, and term loan (see Note 8, “Borrowings,” of the Notes to Condensed Consolidated Financial Statements).

Interest expense is summarized as follows (in thousands, except percentages):

	July 29, 2017		July 30, 2016		Increase	% Change
	Expense	% of Net Revenues	Expense	% of Net Revenues		
Interest expense:						
Three months ended	\$ (15,875)	(2.9)%	\$ (13,462)	(2.3)%	\$ (2,413)	(17.9)%
Nine months ended	\$ (47,317)	(2.8)%	\$ (33,282)	(2.0)%	\$ (14,035)	(42.2)%

Interest expense increased for the three and nine months ended July 29, 2017, compared with the three and nine months ended July 30, 2016, primarily due to the additional \$800.0 million term loan borrowing we completed in the third quarter of fiscal year 2016 to fund the Ruckus acquisition (see Note 8, “Borrowings,” of the Notes to Condensed Consolidated Financial Statements).

*Interest and other income, net.* Interest and other income, net, is summarized as follows (in thousands, except percentages):

	July 29, 2017		July 30, 2016		Increase	% Change
	Income	% of Net Revenues	Income	% of Net Revenues		
Interest and other income, net:						
Three months ended	\$ 2,580	0.5%	\$ 1,557	0.3%	\$ 1,023	65.7%
Nine months ended	\$ 5,136	0.3%	\$ 3,317	0.2%	\$ 1,819	54.8%

The increase in interest and other income, net, for the three months ended July 29, 2017, compared with the three months ended July 30, 2016, was primarily due to an increase in interest rates. The increase in interest and other income, net, for the nine months ended July 29, 2017, compared with the nine months ended July 30, 2016, was primarily related to an increase in interest rates, partially offset by foreign exchange losses as a result of the U.S. dollar weakening against certain foreign currencies.

*Income tax expense (benefit).* Income tax expense (benefit) and the effective tax rates are summarized as follows (in thousands, except effective tax rates):

	Three Months Ended		Nine Months Ended	
	July 29, 2017	July 30, 2016	July 29, 2017	July 30, 2016
Income tax expense (benefit)	\$ (13,622)	\$ (1,806)	\$ (27,275)	\$ 47,034
Effective tax rate	41.1%	(20.8)%	42.8%	24.2%

In general, our provision for income taxes differs from the tax computed at the U.S. federal statutory tax rate due to state taxes, non-U.S. operations being taxed at rates lower than the U.S. federal statutory tax rate, non-deductible stock-based compensation expense, tax credits, and adjustments to unrecognized tax benefits. The non-U.S. operations primarily relate to our European, Asia Pacific, and Japanese subsidiaries.

We recorded an income tax benefit for the three and nine months ended July 29, 2017, primarily due to an operating loss before tax for the three months ended July 29, 2017, and an operating loss before tax and a net discrete benefit from reserve releases as a result of reaching settlement on certain transfer pricing issues with the Geneva Tax Administration (“GTA”) during the nine months ended July 29, 2017. We recorded an income tax benefit for the three months ended July 30, 2016, and an income tax expense for the nine months ended July 30, 2016.

The effective tax rate for the three months ended July 29, 2017, was higher than the U.S. federal statutory tax rate of 35% primarily due to the U.S. pre-tax loss being partially offset by pre-tax income from outside of the United States, which is generally taxed at lower than the 35%, increasing the relative tax benefits compared to the pre-tax consolidated loss.

The effective tax rate for the nine months ended July 29, 2017, was higher than the U.S. federal statutory tax rate of 35% primarily due to the U.S. pre-tax loss being partially offset by pre-tax income from outside of the United States, which is generally taxed at lower than the 35%, increasing the relative tax benefits compared to the pre-tax consolidated loss, and a net discrete benefit as a result of reaching settlement with the GTA.

Our income tax provision could change as a result of many factors, including the effects of changing tax laws and regulations or changes to the mix of IP Networking versus SAN products, which have different gross margins, and changes to the mix of domestic versus international profits. Many of these factors are largely impacted by the buying patterns of our OEM and channel partners. As estimates and judgments are used to project such domestic and international earnings, the impact to our future tax provision could vary if the current planning or assumptions change. In addition, we do not forecast discrete events, such as settlement of tax audits with governmental authorities, due to their inherent uncertainty. Such settlements have in the past, and could in the future, materially impact our tax expense.

For further discussion of our income tax provision, see Note 13, "Income Taxes," of the Notes to Condensed Consolidated Financial Statements.

## Liquidity and Capital Resources

	July 29, 2017	October 29, 2016	Decrease
	(In thousands)		
Cash and cash equivalents	\$ 1,179,369	\$ 1,257,075	\$ (77,706)
Percentage of total assets	25%	25%	

We use cash generated by operations and cash on hand as our primary sources of liquidity. We expect that cash provided by operating activities will fluctuate in future periods as a result of a number of factors, including fluctuations in our revenues, the impact on customer orders due to the recent announcement of Broadcom's intent to acquire us and its planned divestiture of certain portions of our IP Networking business, the timing of product shipments, accounts receivable collections, inventory and supply chain management, the timing and amount of tax, and other payments or receipts. For additional discussion, see "Part II—Other Information, Item 1A. Risk Factors" of this Quarterly Report on Form 10-Q.

Based on past performance and current expectations, we believe that for at least the next 12 months, internally generated cash flows and cash on hand will be generally sufficient to support business operations, capital expenditures, contractual obligations, and other liquidity requirements, including our debt service requirements. In addition, we have up to \$100.0 million available under our revolving credit facility to provide additional liquidity. There are no other transactions, arrangements, or other relationships with unconsolidated entities or other persons that are reasonably likely to materially affect liquidity of, availability of, or our requirements for, capital resources.

## Financial Condition

Our operating cash flows and cash on hand provide liquidity for operations, capital investment, and other strategic initiatives, and to return capital to stockholders. In the third quarter of fiscal year 2014, our Board of Directors initiated a quarterly cash dividend of \$0.035 per share of our common stock. Beginning in the third quarter of fiscal year 2015, our Board of Directors increased our quarterly cash dividend to \$0.045 per share of our common stock. Beginning in the third quarter of fiscal year 2016, our Board of Directors increased our quarterly cash dividend to and subsequently declared a dividend of \$0.055 per share of our common stock. On August 23, 2017, our Board of Directors declared a quarterly cash dividend of \$0.055 per share of our common stock to be paid on October 3, 2017, to stockholders of record as of the close of market on September 11, 2017. Future dividends are subject to review and approval on a quarterly basis by our Board of Directors and are limited under the terms of the Merger Agreement.

Net cash provided by operating activities for the nine months ended July 29, 2017, totaled \$44.6 million and was primarily due to our operating income when excluding non-cash items, partially offset by cash used for changes in assets and liabilities.

Net cash provided by investing activities for the nine months ended July 29, 2017, totaled \$3.4 million and was primarily the result of \$31.8 million in net proceeds from the sale of a software product line, partially offset by \$28.6 million in purchases of property and equipment.

Net cash used in financing activities for the nine months ended July 29, 2017, totaled \$127.4 million and was primarily the result of \$67.4 million in cash dividend payments, \$60.0 million in payment of principal related to the term loan facility of \$800.0 million (the "Term Loan Facility"), and \$41.3 million in cash paid as part of a settlement with a dissenting Ruckus stockholder, partially offset by the \$41.3 million in proceeds from the issuance of common stock from ESPP purchases and stock option exercises. Effective November 2, 2016, stock repurchases are generally prohibited under the terms of the Merger Agreement.

Net proceeds from the issuance of common stock in connection with employee participation in our equity compensation plans have historically been a significant component of our liquidity. The extent to which we receive proceeds from these plans can increase or decrease based upon changes in the market price of our common stock, and from the amount and type of awards granted. For example, we have changed the mix of restricted stock unit and stock option awards granted towards granting fewer stock option awards in recent years, which reduces the net proceeds from the issuance of common stock in connection with participation in our equity compensation plans. As a result, our cash flow resulting from the issuance of common stock in connection with employee participation in our equity compensation plans has varied over time. In addition, our incoming cash flow has been impacted by the suspension of our ESPP, which took effect in the first quarter of fiscal year 2017.

A majority of our accounts receivable balance is derived from U.S. dollar-denominated sales to our OEM partners. We perform ongoing credit evaluations of our customers and generally do not require collateral or security interests on accounts receivable balances. We have established reserves for credit losses and sales allowances. While we have not experienced material credit losses in any of the periods presented, there can be no assurance that we will not experience material credit losses in the future.

## Summary of Cash Flows Data

	Nine Months Ended	
	July 29, 2017	July 30, 2016
	(In thousands)	
Net cash provided by operating activities	\$ 44,632	\$ 252,906
Net cash provided by (used in) investing activities	3,401	(476,125)
Net cash used in financing activities	(127,445)	(63,663)
Effect of exchange rate fluctuations on cash and cash equivalents	1,706	(926)
Net decrease in cash and cash equivalents	\$ (77,706)	\$ (287,808)

## Nine Months Ended July 29, 2017, Compared to Nine Months Ended July 30, 2016

*Operating Activities.* Cash provided by operating activities is net income (loss) adjusted for certain non-cash items and changes in certain assets and liabilities.

Net cash provided by operating activities decreased by \$208.3 million primarily due to lower operating income and the related net loss position for the nine months ended July 29, 2017, as compared to the net income for the nine months ended July 30, 2016, as well as due to increased payments with respect to accounts payable.

*Investing Activities.* Net cash used in investing activities decreased by \$479.5 million primarily due to a decrease in cash used for acquisitions and a decrease in cash used to purchase property and equipment during the nine months ended July 29, 2017, as compared to the nine months ended July 30, 2016, and the receipt of the net proceeds from the sale of a software product line. This decrease was partially offset by the lack of any proceeds from maturities and sale of short-term investments during the nine months ended July 29, 2017.

*Financing Activities.* Net cash used in financing activities increased by \$63.8 million primarily due to the \$60.0 million in principal payments under the Term Loan Facility (no principal payments were made during the prior-year period), a \$41.3 million payment of accrued merger consideration as part of a settlement with a dissenting Ruckus stockholder during the nine months ended July 29, 2017, and the lack of incremental borrowings under the Term Loan Facility during the nine months ended July 29, 2017. This increase was partially offset by a lack of common stock repurchases during the nine months ended July 29, 2017.

## Liquidity

*Manufacturing and Purchase Commitments.* We have manufacturing arrangements with contract manufacturers under which we provide up to 12-month product forecasts and place purchase orders in advance of the scheduled delivery of products to our customers. Our purchase commitments reserve reflects our estimate of purchase commitments we do not expect to utilize in normal operations in accordance with our policy (see Note 9, "Commitments and Contingencies," of the Notes to Condensed Consolidated Financial Statements).

*Income Taxes.* We intend to indefinitely reinvest all current and accumulated earnings of our foreign subsidiaries for expansion of our business operations outside the United States. Therefore, we do not currently accrue U.S. income taxes on the earnings of our foreign subsidiaries.

Our existing cash and cash equivalents totaled \$1,179.4 million as of July 29, 2017. Of this amount, approximately 92% was held by our foreign subsidiaries. We do not currently anticipate a need for these funds held by our foreign subsidiaries for our domestic operations, including dividends, payment of interest on our debt, and mandatory repayment of our Term Loan Facility, and our intent is to permanently reinvest such funds outside of the United States. Under current tax laws and regulations, if these funds are distributed to any of our United States entities in the form of dividends or otherwise, we may be subject to additional U.S. income taxes and foreign withholding taxes.

The IRS and other tax authorities regularly examine our income tax returns (see Note 13, "Income Taxes," of the Notes to Condensed Consolidated Financial Statements). We believe we have adequate reserves for all open tax years.

*Senior Unsecured Notes.* In January 2013, we issued \$300.0 million in aggregate principal amount of the 2023 Notes. We used the proceeds from the issuance of the 2023 Notes and cash on hand to redeem all of the outstanding principal amount of senior secured notes due 2018 in the second quarter of fiscal year 2013. See Note 8, "Borrowings," of the Notes to Condensed Consolidated Financial Statements.

The 2023 Notes were issued pursuant to an indenture, dated as of January 22, 2013, among the subsidiary guarantors named therein, us, and Wells Fargo Bank, National Association, as trustee (the "2023 Indenture"). The 2023 Indenture contains covenants that, among other things, restrict our ability and the ability of our subsidiaries to:

- Incur certain liens and enter into certain sale-leaseback transactions;
- Create, assume, incur, or guarantee additional indebtedness of our subsidiaries without such subsidiaries guaranteeing the 2023 Notes on a pari passu basis; and
- Enter into certain consolidation or merger transactions, or convey, transfer, or lease all, or substantially all of our or our subsidiaries' assets.

These covenants are subject to a number of other limitations and exceptions as set forth in the 2023 Indenture. We were in compliance with all applicable covenants of the 2023 Indenture as of July 29, 2017.

*Convertible Senior Unsecured Notes.* In January 2015, we issued \$575.0 million in aggregate principal amount of the 2020 Convertible Notes pursuant to an indenture, dated as of January 14, 2015, between us and Wells Fargo Bank, National Association, as the trustee (the "2015 Indenture"). Net of an original issue discount, we received \$565.7 million in proceeds from the offering of the 2020 Convertible Notes. We used a portion of the net proceeds to discharge the 2020 Indenture and redeem all of the outstanding principal amount of the 2020 Notes, pay \$35.0 million for the cost of the convertible note hedge transactions, net of the proceeds from the issuance of warrants, and to repurchase approximately 4.1 million shares of our common stock for \$48.9 million at a purchase price of \$11.80 per share, which was the closing price on January 8, 2015, the date of the pricing of the 2020 Convertible Notes. We intend to use the remaining net proceeds of \$159.6 million for general corporate purposes, including potential acquisitions and other business development activities. The 2020 Convertible Notes are unsecured and have a significantly lower interest rate of 1.375% compared to 6.875% for the 2020 Notes. Interest is payable on January 1 and July 1 of each year, beginning on July 1, 2015. See Note 8, "Borrowings," of the Notes to Condensed Consolidated Financial Statements.

*Senior Credit Facility.* On May 27, 2016, we entered into a credit agreement (the "Credit Agreement") with Wells Fargo Bank, Deutsche Bank AG New York Branch, SunTrust Bank and certain other lenders. The Credit Agreement provided us with the Term Loan Facility of \$800.0 million, which was fully drawn at the time of, and the proceeds used to fund in part, the Ruckus acquisition, and the Revolving Facility of \$100.0 million, which is available to finance ongoing working capital requirements and other general corporate purposes. The initial term loan has a term of five years and bears interest at floating rates based on LIBOR, plus a 1.5% interest margin. See Note 8, "Borrowings," of the Notes to Condensed Consolidated Financial Statements.

There were no principal amounts outstanding under the Revolving Facility, and the full \$100.0 million was available for future borrowing under the Revolving Facility as of July 29, 2017. During the nine months ended July 29, 2017, we made payments totaling \$60.0 million towards the principal of the Term Loan Facility.

We are required to make mandatory prepayments of the Term Loan Facility (without payment of a premium or penalty) with the net cash proceeds from any issuances of debt not permitted under the Credit Agreement, net cash proceeds from certain non-ordinary course asset sales (subject to reinvestment rights and other exceptions), and casualty proceeds and condemnation awards (subject to reinvestment rights and other exceptions). Commencing October 31, 2016, the loans under the Term Loan Facility will amortize in equal quarterly installments in an aggregate annual amount equal to 10% of the original principal amount thereof, with any remaining balance payable on the final maturity date of the loans under the Term Loan Facility.

The Credit Agreement contains financial maintenance covenants, including (i) a maximum total leverage ratio as of the last date of any fiscal quarter which, prior to the amendment to the Credit Agreement discussed below, was not to exceed 3.50 to 1, subject to certain step-downs to 3.25 to 1 and 3.00 to 1 for fiscal periods ending on or after April 30, 2017, and April 30, 2018, respectively, and (ii) a minimum interest coverage ratio of not less than 3.50 to 1.

On August 11, 2017, we amended the Credit Agreement, effective for our third quarter of fiscal year 2017, to modify the consolidated total leverage ratio covenant to (i) postpone the effective date of the previously scheduled third fiscal quarter reduction in the maximum permitted consolidated total leverage ratio from 3.50 to 1 to 3.25 to 1 until our 2018 fiscal year, thus keeping the maximum permitted ratio at 3.50 to 1 for both our third and fourth quarters of fiscal year 2017, and (ii) temporarily suspend the applicability of an existing 15% limit on the amount of certain expenses, including acquisition, integration, and restructuring expenses, that may be added back when calculating consolidated EBITDA for purposes of financial covenant compliance for both our third and fourth quarters of fiscal year 2017.

The Credit Agreement also contains restrictive covenants that limit, among other things, our and certain of our subsidiaries' ability to:

- Incur additional indebtedness or issue certain preferred equity, pay dividends or make other distributions or other restricted payments (including stock repurchases);
- Sell assets other than on terms specified by the Credit Agreement;
- Amend the terms of certain other indebtedness and organizational documents;
- Create liens on certain assets to secure debt, consolidate, merge, sell, or otherwise dispose of all or substantially all of their assets; and
- Enter into certain transactions with affiliates, or change their lines of business, fiscal years, and accounting practices, in each case, subject to customary exceptions.

These covenants are subject to a number of other limitations and exceptions as set forth in the Credit Agreement. We were in compliance with all applicable covenants of the Credit Agreement as of July 29, 2017.

The obligations under the Term Loan Facility and certain cash management and hedging obligations are fully and unconditionally guaranteed by certain of our direct and indirect subsidiaries. On May 27, 2016, subsequent to the completion of the Ruckus acquisition, and in accordance with the covenants contained in the 2023 Indenture and 2015 Indenture, Ruckus, us, and certain other of our subsidiaries, and Wells Fargo Bank, N.A., as trustee, entered into supplemental indentures pursuant to which such subsidiaries fully and unconditionally guaranteed our obligations under the 2023 Indenture and 2015 Indenture.

*Impact of Broadcom Acquisition.* The consummation of the proposed acquisition of Brocade by Broadcom would constitute a "Fundamental Change" under the terms of the 2020 Convertible Notes and a "Change in Control" under the Credit Agreement, would result in a termination of the warrant transactions we entered into in connection with the 2020 Convertible Notes, and could result in a "Change of Control Triggering Event" under the 2023 Notes. In addition, the consummation of the proposed acquisition would result in a temporary adjustment to the conversion rate for the 2020 Convertible Notes. The payment obligations arising out of the occurrence of such events could materially impact our cash flows and financial position, and we and/or the acquirer may not have enough available cash or be able to obtain financing on acceptable terms (or at all) at the time to discharge those payment obligations. See "Risk Factors—The consummation of the proposed Broadcom acquisition could result in substantial obligations becoming payable in respect of the 2020 Convertible Notes, the Warrant Transactions, the 2023 Notes, and the Credit Agreement, which could negatively impact Brocade's cash flows and financial position" and Note 8, "Borrowings," of the Notes to Condensed Consolidated Financial Statements.

*Stock Repurchase Program.* As of July 29, 2017, our Board of Directors had authorized a total of approximately \$3.5 billion for the repurchase of our common stock since the inception of the program in August 2004. The purchases may be made, from time to time, in the open market or by privately negotiated transactions, and are funded from available working capital. The number of shares to be purchased and the timing of purchases are based on the level of our cash balances, general business and market conditions, the trading price of our common stock, and other factors, including alternative investment opportunities. For the nine months ended July 29, 2017, we had no stock repurchases. Approximately \$979.4 million remained authorized for future repurchases under this program as of July 29, 2017. We are generally prohibited under the terms of the Merger Agreement with Broadcom from executing repurchases under this program.



*Impact of Fourth Quarter Fiscal Year 2017 Workforce Reduction Plan.* On August 11, 2017, our Board of Directors approved a workforce reduction plan pursuant to which approximately 230 additional employees in the United States are expected to exit Brocade during our fourth quarter of fiscal year 2017. We expect to make cash expenditures of approximately \$23 million to \$26 million in our fourth quarter of fiscal year 2017 for severance and other employee termination costs associated with the workforce reduction plan.

### Contractual Obligations

The following table summarizes our contractual obligations, including interest expense, and commitments as of July 29, 2017 (in thousands):

	Total	Less Than 1 Year	1–3 Years	3–5 Years	More Than 5 Years
<b>Contractual Obligations:</b>					
Term Loan Facility <sup>(1)</sup>	\$ 786,699	\$ 100,763	\$ 194,652	\$ 491,284	\$ —
Convertible senior unsecured notes due 2020 <sup>(1)</sup>	594,092	7,906	11,186	575,000	—
Senior unsecured notes due 2023 <sup>(1)</sup>	375,893	13,875	27,750	27,750	306,518
Non-cancellable operating leases <sup>(2)</sup>	86,270	21,826	26,827	22,420	15,197
Purchase obligations <sup>(1)</sup>	13,381	2,227	4,056	4,056	3,042
Purchase commitments, gross <sup>(3)</sup>	160,702	160,702	—	—	—
Total contractual obligations	<u>\$ 2,017,037</u>	<u>\$ 307,299</u>	<u>\$ 264,471</u>	<u>\$ 1,120,510</u>	<u>\$ 324,757</u>
<b>Other Commitments:</b>					
Standby letters of credit	<u>\$ 138</u>	<u>n/a</u>	<u>n/a</u>	<u>n/a</u>	<u>n/a</u>
Unrecognized tax benefits and related accrued interest <sup>(4)</sup>	<u>\$ 193,305</u>	<u>n/a</u>	<u>n/a</u>	<u>n/a</u>	<u>n/a</u>

<sup>(1)</sup> Amount reflects total anticipated cash payments, including anticipated interest payments.

<sup>(2)</sup> Amount excludes contractual sublease income of \$0.4 million, which consists of \$0.2 million to be received in less than one year and \$0.2 million to be received in one to three years.

<sup>(3)</sup> Amount reflects total gross purchase commitments under our manufacturing arrangements with third-party contract manufacturers. Of this amount, we have accrued reserves of \$1.8 million for estimated purchase commitments that we do not expect to utilize in normal operations within the next 12 months, in accordance with our policy.

<sup>(4)</sup> As of July 29, 2017, we had a gross liability for unrecognized tax benefits of \$189.8 million and an accrual for the payment of related interest and penalties of \$3.5 million.

### Off-Balance Sheet Arrangements

As part of our ongoing business, we do not participate in transactions that generate material relationships with unconsolidated entities or financial partnerships, such as entities often referred to as “structured finance” or “special purpose entities,” which would have been established for the purpose of facilitating off-balance sheet arrangements or for other contractually narrow or limited purposes. As of July 29, 2017, we did not have any significant off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

### Critical Accounting Policies and Estimates

There have been no material changes in the matters for which we make critical accounting policies and estimates in the preparation of our Condensed Consolidated Financial Statements during the nine months ended July 29, 2017, as compared to those disclosed in our Annual Report on Form 10-K for the fiscal year ended October 29, 2016.

### Recent Accounting Pronouncements

For a description of recent accounting pronouncements, including the expected dates of adoption and estimated effects, if any, on our Condensed Consolidated Financial Statements, see Note 2, “Summary of Significant Accounting Policies,” of the Notes to Condensed Consolidated Financial Statements.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

In the normal course of business, we are exposed to market risks related to changes in interest rates, foreign currency exchange rates, and equity prices that could impact our financial position and results of operations. Our risk management strategy with respect to these three market risks may include the use of derivative financial instruments. We use derivative contracts only to manage our existing underlying exposures. Accordingly, we do not use derivative contracts for speculative purposes. Our risks and risk management strategy are outlined below. Actual gains and losses in the future may differ materially from the sensitivity analysis presented below based on changes in the timing and level of interest rates and our actual exposures and hedges.

#### **Interest Rate Risk**

Our exposure to market risk due to changes in the general level of U.S. interest rates relates primarily to our Term Loan Facility and cash equivalents.

We are exposed to changes in interest rates as a result of our borrowings under our Term Loan Facility, which in the third quarter of fiscal year 2017 bore interest at floating rates based on LIBOR plus a 1.5% interest margin. Based on outstanding principal indebtedness of \$720.0 million under our Term Loan Facility as of July 29, 2017, if market rates average 1% above the current interest rate, our annual interest expense would increase by approximately \$7.2 million. Our remaining material borrowings as of July 29, 2017, bear interest at fixed rates and therefore were not sensitive to changes in interest rates.

Our cash and cash equivalents are primarily maintained at five major financial institutions. The primary objective of our investment activities is the preservation of principal while maximizing investment income and minimizing risk. We had \$824.9 million invested in money market funds as of July 29, 2017, which were not materially sensitive to changes in interest rates due to the short duration of these investments.

We were not subject to material interest rate risk in geographical areas outside of the United States as a substantial portion of our cash and cash equivalents is invested in money market funds in U.S. dollars that have a fixed share price.

#### **Foreign Currency Exchange Rate Risk**

We are exposed to foreign currency exchange rate risk inherent in conducting business globally in numerous currencies. We are primarily exposed to foreign currency fluctuations related to operating expenses denominated in currencies other than the U.S. dollar, of which the most significant to our operations for the nine months ended July 29, 2017, were the British pound, the euro, the Indian rupee, the Chinese yuan, the Singapore dollar, the Japanese yen, the Taiwan new dollar, the Australian dollar, the Canadian dollar, the Israeli shekel, the Swiss franc, and the Hong Kong dollar. Because we report in U.S. dollars and we have a net expense position in foreign currencies, we benefit from a stronger U.S. dollar and may be adversely affected by a weaker U.S. dollar relative to the foreign currency. We use foreign currency forward and option contracts designated as cash flow hedges to protect against the foreign currency exchange rate risks inherent in our forecasted operating expenses denominated in certain currencies other than the U.S. dollar. We recognize the gains and losses on foreign currency forward contracts in the same period as the remeasurement losses and gains of the related foreign currency denominated exposures.

We also may enter into other non-designated derivatives that consist primarily of forward contracts to minimize the risks associated with the foreign exchange effects of revaluing monetary assets and liabilities. Monetary assets and liabilities denominated in foreign currencies and any associated outstanding forward contracts are marked-to-market, with realized and unrealized gains and losses included in earnings.

Alternatively, we may choose not to hedge the foreign currency risk associated with our foreign currency exposures if we believe such exposure acts as a natural foreign currency hedge for other offsetting amounts denominated in the same currency or if the currency is difficult or too expensive to hedge. As of July 29, 2017, the gross notional amount of our cash flow derivative instruments was \$40.6 million, and we had hedges in place through October 4, 2017.

We have performed a sensitivity analysis as of July 29, 2017, using a modeling technique that measures the change in the fair values arising from a hypothetical 10% adverse movement in the levels of foreign currency exchange rates relative to the U.S. dollar, with all other variables held constant. The analysis covers all of our foreign currency contracts offset by the underlying exposures. The foreign currency exchange rates we used were based on market rates in effect on July 29, 2017. The sensitivity analysis indicated that a hypothetical 10% adverse movement in foreign currency exchange rates would not result in a material foreign exchange loss as of July 29, 2017.

## Equity Price Risk

From time to time, we have made equity investments in companies that develop technology or provide services that are complementary to, or broaden the markets for, our products or services and further our business objectives. We had no investments in publicly traded equity securities as of July 29, 2017. The aggregate fair value of our equity investments in non-publicly traded companies was \$2.0 million as of July 29, 2017. We monitor our equity investments for impairment on a periodic basis. In the event that the carrying value of the equity investment exceeds its fair value, and we determine the decline in value to be other than temporary, we reduce the carrying value to its current fair value. Consequently, during the three and nine months ended July 29, 2017, an aggregate impairment charge of \$2.9 million on our equity investments was recognized in the Company's Condensed Consolidated Statements of Operations to reflect updated fair value estimates for our equity investments. Generally, we do not attempt to reduce or eliminate our market exposure on these equity securities. We do not purchase our equity securities with the intent to use them for speculative purposes.

Our common stock is quoted on the NASDAQ Global Select Market under the symbol "BRCD." On July 28, 2017, the last business day of our third fiscal quarter of 2017, the last reported sale price of our common stock on the NASDAQ Global Select Market was \$12.58 per share.

## Item 4. Controls and Procedures

(a) *Evaluation of Disclosure Controls and Procedures.* Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Act"), as of the end of the period covered by this Quarterly Report on Form 10-Q (the "Evaluation Date").

The purpose of this evaluation is to determine if, as of the Evaluation Date, our disclosure controls and procedures are effective such that the information required to be disclosed in the reports we file or submit under the Act (i) is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective.

(b) *Changes in Internal Control over Financial Reporting.* There were no changes in our internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Act, that occurred during the quarter ended July 29, 2017, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### *Limitations on the Effectiveness of Disclosure Controls and Procedures.*

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or internal control over financial reporting will prevent all errors and all fraud. A control system, no matter how well designed and implemented, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues within a company are detected. The inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple errors or mistakes. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

## PART II — OTHER INFORMATION

## Item 1. Legal Proceedings

### *Acquisition-Related Litigation*

The information set forth under the heading “Ruckus Acquisition-Related Litigation,” “Ruckus Acquisition-Related Appraisal Demand,” and “Broadcom Acquisition-Related Litigation” in Note 9, “Commitments and Contingencies,” of the Notes to Condensed Consolidated Financial Statements in Part I, Item 1 of this Form 10-Q is incorporated herein by reference.

### *Other Legal Proceedings*

From time to time, the Company is subject to various legal proceedings and claims, either asserted or unasserted, which arise in the ordinary course of business, including claims of alleged infringement of patents and/or other intellectual property rights and commercial and employment contract disputes. While the outcome of these matters cannot be predicted with certainty, the Company does not believe that the outcome of any of these matters, individually or in the aggregate, will result in losses that are materially in excess of amounts already accrued by the Company.

## Item 1A. Risk Factors

*The announcement and pendency of Brocade’s agreement to be acquired by Broadcom Limited (“Broadcom”) and Broadcom’s planned divestiture of certain portions of Brocade’s Internet Protocol (“IP”) Networking business has had and may continue to have an adverse effect on Brocade’s business and operating results.*

On November 2, 2016, Brocade entered into a merger agreement with Broadcom under which Broadcom agreed to acquire Brocade. In connection with the announcement of the proposed acquisition, Broadcom announced its intention to retain Brocade’s Storage Area Networking (“SAN”) business and divest certain portions of Brocade’s IP Networking business. Brocade’s pending acquisition by Broadcom, and Broadcom’s announcement of its plans to divest certain portions of Brocade’s IP Networking business, has had and may continue to have an adverse effect on Brocade’s revenue in the near term if its customers delay, defer, or cancel purchases pending completion of the transactions. In addition, on February 22, 2017, Broadcom announced that it had entered into an agreement with ARRIS International plc (“ARRIS”) to divest Brocade’s wireless and campus business to ARRIS, and on March 29, 2017, Broadcom announced that it had entered into an agreement with Extreme Networks, Inc. (“Extreme Networks”) to divest Brocade’s data center, switching, routing, and analytics business to Extreme Networks, in each case, contingent on and following Broadcom’s acquisition of Brocade. In addition, as announced on June 27, 2017, Brocade entered into an agreement with Hitachi Data Systems Federal Corporation (“HDS Federal”) to transfer support and services obligations for Brocade’s U.S. federal cleared contracts to HDS Federal, coincident with Broadcom’s acquisition of Brocade. These announcements of planned divestitures of certain portions of Brocade’s IP Networking business may create additional uncertainty. Current and prospective customers of Brocade’s products and services, including its SAN and IP Networking solutions, have been and may continue to be reluctant to purchase Brocade solutions due to potential uncertainty about the direction of its offerings and the support and service of its offerings following consummation of the transactions. Brocade is subject to additional risks in connection with the announcement and pendency of the proposed transactions, including:

- difficulties maintaining existing and/or establishing business relationships, including relationships with significant customers, contract manufacturers, component suppliers, channel partners, and other business partners;
- disruption to Brocade’s business, including increased costs and diversion of management time and resources that could otherwise have been devoted to other opportunities that may have been beneficial to Brocade;
- the restrictions imposed on Brocade’s business and operations pursuant to certain covenants set forth in the merger agreement, which may prevent Brocade from pursuing certain opportunities, responding to competitive pressures and industry developments, or taking certain actions without Broadcom’s approval;
- continued erosion of EBITDA that may lead to long-term noncompliance with debt financial covenants and erosion of domestic cash;
- adverse effects on Brocade’s ability to attract, recruit, retain and motivate current and prospective employees who may be uncertain about their future roles following completion of the proposed transactions, and the possibility that Brocade’s employees could lose productivity as a result of uncertainty regarding their employment following the proposed transactions;
- the pendency and outcome of the legal proceedings that have been or may be instituted against Brocade, its directors, executive officers and others relating to the proposed transactions;



- announcements related to the proposed transactions could result in adjustments to the terms of the warrant transactions (the “Warrant Transactions”) Brocade entered into in connection with the issuance of the 1.375% convertible senior unsecured notes due 2020 (the “2020 Convertible Notes”); and
- the diversion of Brocade’s employees’ attention due to activities related to the proposed transactions.

As noted above, on February 22, 2017, and March 29, 2017, Broadcom announced its plans to divest certain portions of Brocade’s IP Networking business to each of ARRIS and Extreme Networks following Broadcom’s acquisition of Brocade. In addition, as announced on June 27, 2017, Brocade entered into an agreement to transfer support and services obligations under its U.S. federal cleared contracts to HDS Federal, coincident with Broadcom’s acquisition of Brocade. Uncertainties regarding these transactions and any planned divestiture of other portions of Brocade’s IP Networking business, including the completion and timing of any such divestiture, the identity of the buyer or buyers, and the terms and conditions of any such transaction or transactions, have exacerbated and may continue to exacerbate certain of the risks described above in relation to this business.

Since the announcement of the proposed Broadcom acquisition, Brocade has experienced increased acquisition and integration expenses and lower earnings, which have negatively impacted the Company’s debt-to-EBITDA ratio. Under Brocade’s Credit Agreement (the “Credit Agreement”) with Wells Fargo Bank, National Association, and certain other lenders (collectively, the “Lenders”), Brocade is required to maintain a maximum debt-to-EBITDA ratio. Accordingly, Brocade and the Lenders have entered into an amendment to the Credit Agreement to provide for additional flexibility in complying with this covenant for the third and fourth quarters of fiscal year 2017.

***The failure to complete Brocade’s pending acquisition by Broadcom may adversely affect Brocade’s business, financial condition, operating results, and stock price.***

Consummation of the acquisition remains subject to certain customary closing conditions, including, without limitation: the absence of legal impediments, and review and clearance by the Committee on Foreign Investment in the United States (“CFIUS”). On July 17, 2017, Brocade and Broadcom agreed to withdraw and re-file their joint voluntary notice to CFIUS to allow more time for review and discussion with CFIUS in connection with the proposed acquisition. There can be no assurance that these conditions to the completion of the merger, including review and clearance by CFIUS, will be satisfied in a timely manner or at all. If the merger is not completed, Brocade’s stock price could fall to the extent its current price reflects an assumption that the acquisition will be completed. Furthermore, if the acquisition is not completed, Brocade may suffer other consequences that could adversely affect its business, financial condition, operating results, and stock price, including the following:

- any disruptions to Brocade’s business resulting from the announcement and pendency of the proposed transactions, including adverse changes in its relationships with customers, suppliers, channel partners, other business partners and employees, may continue or intensify in the event the acquisition is not consummated or is significantly delayed;
- Brocade would have incurred significant costs, including professional services fees and other transaction costs, in connection with the proposed transactions that it would be unable to recover;
- Brocade may experience continued erosion of EBITDA that may lead to long-term noncompliance with debt financial covenants and erosion of domestic cash;
- Brocade may be subject to negative publicity or be negatively perceived by the investment or business communities;
- Brocade may be subject to legal proceedings related to the transactions contemplated by the merger agreement;
- Brocade may not be able to take advantage of alternative business opportunities or effectively respond to competitive pressures; and
- Brocade may experience a departure of employees.

***The merger agreement with Broadcom limits Brocade’s ability to pursue alternative transactions, which could deter a third party from proposing an alternative transaction.***

The merger agreement contains provisions that limit Brocade’s ability to pursue an alternative acquisition transaction. These or other provisions may discourage a potential competing acquirer that might have an interest in acquiring all or a significant part of Brocade from considering or proposing an acquisition.



***Litigation challenging the merger agreement may prevent the merger from being consummated at all or within the expected time frame and may result in substantial costs to Brocade.***

In December 2016 and January 2017, six putative class-action lawsuits (the “Broadcom acquisition-related matters”) were commenced against, among others, Brocade and its directors in the United States District Court for the Northern District of California. The complaints each allege violations of Sections 14(a) and 20(a) of the Exchange Act and one or more SEC rules arising out of Brocade’s preliminary and definitive proxy statements filed with the SEC on December 6 and December 20, 2016, respectively, relating to the proposed merger. Among other things, the plaintiffs in these actions seek to enjoin the defendants from consummating the proposed merger. Brocade stockholders, as plaintiffs, may initiate further stockholder class-action lawsuits also seeking, among other things, to enjoin consummation of the merger. One of the conditions to the consummation of the merger is that no governmental entity of competent jurisdiction shall have issued an order or decree that prohibits or prevents the consummation of the merger on the terms contemplated in the merger agreement. There can be no assurance that Brocade and the other defendants in these lawsuits will be successful in their defenses. An unfavorable outcome in any such lawsuit could prevent or delay the consummation of the merger and, regardless of the outcome, may result in substantial costs to Brocade and may otherwise negatively affect its business and operations. For additional information regarding the Broadcom acquisition-related matters, see Note 9, “Commitments and Contingencies,” of the Notes to Condensed Consolidated Financial Statements in Part I, Item 1 of this Form 10-Q.

***The consummation of the proposed Broadcom acquisition could result in substantial obligations becoming payable in respect of the 2020 Convertible Notes, the Warrant Transactions, the 2023 Notes, and the Credit Agreement, which could negatively impact Brocade’s cash flows and financial position.***

The proposed acquisition of Brocade by Broadcom would constitute a “Fundamental Change” under the terms of the 2020 Convertible Notes, would constitute a “Change in Control” under the Credit Agreement, would result in a termination of the Warrant Transactions, and could result in a “Change of Control Triggering Event” under the 4.625% senior notes due 2023 (the “2023 Notes”). In addition, the consummation of the proposed transaction would result in a temporary adjustment to the conversion rate for the 2020 Convertible Notes. Specifically:

- Holders of the 2020 Convertible Notes have the right to require Brocade to repurchase their convertible notes upon the occurrence of a “Fundamental Change” (as defined in the indenture governing the 2020 Convertible Notes) at a repurchase price of 100% of the principal amount plus accrued and unpaid interest, if any.
- The 2020 Convertible Notes would become convertible for a specified period of time following the consummation of the proposed Broadcom acquisition, which would require Brocade to make cash payments up to the full conversion value of any notes being converted; Brocade could not elect to settle the conversion of the notes with shares of its common stock.
- Holders of the 2023 Notes have the right to require Brocade to repurchase their notes upon the occurrence of a “Change of Control Triggering Event” (as defined in the indenture governing the 2023 Notes), at a repurchase price equal to 101% of the principal amount plus accrued and unpaid interest, if any. The proposed Broadcom acquisition would result in a Change of Control Triggering Event if the acquisition were accompanied or followed within a specific period by certain downgrades of the ratings of the 2023 Notes.
- A “Change of Control” under the Credit Agreement would constitute an event of default and permit the Lenders to cause the acceleration of the repayment of all of the outstanding amounts owed thereunder.
- Upon termination of the Warrant Transactions in connection with the proposed Broadcom acquisition, Brocade would be required to settle such transactions in cash. Further, announcements relating to the proposed acquisition may result in adjustments to the terms of the Warrant Transactions to take into account the economic effect of the proposed acquisition, which could result in greater amounts becoming due upon termination or otherwise have a dilutive effect.

The foregoing payment obligations would materially impact Brocade’s cash flows and financial position, and Brocade may not have enough available cash or be able to obtain financing on acceptable terms (or at all) at the time to discharge those payment obligations.

***Failure to successfully compete in the networking market could prevent Brocade from increasing or maintaining revenue, profitability, and cash flows with respect to its networking solutions.***

The networking market is highly competitive and is undergoing significant transitions due to the adoption of new technologies, such as cloud computing, virtualization, software networking, and infrastructure-as-a-service. For example, companies such as Amazon Web Services, Inc., Microsoft Corporation, Cisco Systems, Inc. ("Cisco") and Hewlett Packard Enterprise Company ("HPE") all offer cloud computing services for the enterprise market, and some customers may choose to procure networking as a service rather than implement on-site networking solutions. Brocade sells into certain sections of the enterprise market which, over time, could shift their information technology ("IT") spending substantially or completely to cloud services. If Brocade is unable to build and sustain relationships with companies that will continue to invest in their own on-site networks, Brocade's revenue and profitability could be adversely affected.

Other shifts in the networking market are also creating competitive challenges for Brocade. For example, data center buying patterns are shifting to converged infrastructures in which computer, network, and storage systems are sold as bundled solutions. If Brocade is unsuccessful in having its products included in those bundled solutions, Brocade's market share could be adversely affected. Also, Juniper Networks, Inc. ("Juniper") and HPE have launched new offerings, including "whitebox" switches, which those companies have promoted as a low-cost option for networking equipment purchasers. These and other market dynamics, as well as further commoditization of networking products, could negatively impact Brocade's business and financial results.

Following its acquisition of Ruckus Wireless, Inc. ("Ruckus"), Brocade has become a vendor of wireless networking products. Previously, Brocade had relied on partner relationships developed with other companies for access to wireless networking technologies, including access to wireless networking products to supplement Brocade's wireline campus business. Those partner relationships may be adversely affected by the fact that Brocade now competes with those companies' wireless networking businesses.

Cisco maintains a dominant position in the networking market; however, customers also have many choices in both traditional and emerging networking technology and networking providers. These other competitors in the networking market include A10 Networks, Inc.; Arista Networks, Inc.; Avaya Inc.; Dell, Inc. (now, Dell Technologies Inc. ("Dell Technologies")); Extreme Networks, Inc.; F5 Networks, Inc.; HPE; Huawei Technologies Co. Ltd.; Juniper; Nokia Corporation ("Nokia"); and Nutanix, Inc. Many of Brocade's competitors have longer operating histories; greater financial, technical, sales, marketing, and other resources; more name recognition; and larger customer-installed bases than Brocade. These companies' businesses may have better economies of scale, and therefore these companies could also adopt more aggressive pricing policies than Brocade. Some of these companies' brands are better known by end users than Brocade's brand, and channel partners often prefer to sell well-known brands to end-user accounts. In addition, some of Brocade's current and potential competitors have in the past, and could in the future, enhance their business models through acquisitions, divestitures, or new strategic alliances designed to enable them to better compete for customers by offering more comprehensive solutions. For example, in recent years, Dell Technologies acquired EMC Corporation (now, "Dell EMC"), Cavium, Inc. ("Cavium") acquired QLogic Corporation, and Nokia acquired Alcatel-Lucent. Such industry consolidation may increase competitive dynamics in Brocade's markets, impact Brocade's partner ecosystem, and limit certain routes to market for Brocade's solutions. Also, any one of these competitors could devote more resources to develop, promote, and sell their products, and, therefore, could respond more quickly to changes in customer or market requirements and adopt more aggressive pricing policies. Brocade's failure to successfully compete in the networking market would harm its business and financial results.

***Conditions in the SAN market could adversely affect Brocade's business, financial results, and growth prospects.***

Approximately one-half of Brocade's fiscal year 2016 revenue was generated from its SAN business. As such, Brocade's business, financial results, and growth prospects may be impacted significantly by changes in SAN market conditions. For example, total SAN market revenue contracted in calendar years 2015 and 2016 due to, among other factors, the increasing efficiency of SAN products, the adoption of other networking protocols, changes in data center architectures, hyper-converged solutions and other new storage technologies, and the other competitive factors described in the risk factor above.

Revenue generated from sales of Brocade's SAN products is also impacted by the amount of storage capacity deployed by its SAN customers. While the amount of storage capacity deployed is growing, the rate of that growth has declined in recent years.

In addition, revenue generated from sales of Brocade's SAN products is impacted by the average selling price for those products. While the overall average selling price for Brocade's SAN products has increased in recent periods, that increase has been largely due to the introduction of new products. Accordingly, that trend may not be sustained if Brocade is unable to continue to successfully introduce and obtain customer acceptance of new SAN products at the same rate, or at all.

The health of the overall SAN market will also depend on continued market participation by other SAN ecosystem vendors, such as Broadcom and Cavium, who produce Fibre Channel host bus adapters for servers and interconnect technology for storage arrays.

If Brocade fails to successfully address these SAN market conditions, Brocade's business, financial results, and growth prospects may be adversely affected.

***A limited number of major original equipment manufacturer ("OEM") partners comprise a significant portion of Brocade's revenues; the loss of revenue from, or decreased inventory levels held by, any of these major OEM partners could significantly reduce Brocade's revenues and adversely affect its financial results.***

Brocade's SAN business depends on recurring purchases from a limited number of large OEM partners for a substantial portion of its revenues, specifically Dell EMC, HPE, and International Business Machines Corporation ("IBM"). As a result, revenues from these large OEM partners have a significant impact on Brocade's quarterly and annual financial results. For fiscal years 2016, 2015, and 2014, these three OEM partners each represented 10% or more of Brocade's total net revenues, for a combined total of 36%, 41%, and 46% of total net revenues, respectively. Brocade's agreements with its OEM partners are typically cancellable and nonexclusive, and have no minimum or specific timing requirements for purchases. Brocade's OEM partners could increase the amount purchased from Brocade's competitors, introduce their own technology, or experience lower demand for Brocade SAN products from their end customers.

Also, one or more of Brocade's OEM partners could elect to divest certain lines of business, split their business, or consolidate or enter into a strategic partnership with one of Brocade's competitors, such as IBM's sale of certain lines of business to Lenovo Group Limited, HPE becoming a separate public company, and the acquisition of the former EMC Corporation by Dell Technologies, which could reduce or eliminate Brocade's revenue opportunities with that OEM partner. In addition, business execution or other operating performance issues experienced by Brocade's OEM partners has in the past, and may in the future, adversely affect Brocade's revenue and financial results. Brocade anticipates that a significant portion of its revenues and operating results from its SAN business will continue to depend on sales to a relatively small number of OEM partners. Brocade's business and financial results could be harmed by the loss of any one significant OEM partner, a decrease in the level of sales to any one such partner, a change in any one such partner's go-to-market strategy, or an unsuccessful negotiation on key terms, conditions, or timing of purchase orders placed during a quarter.

***Brocade may not realize the anticipated benefits of past or future acquisitions, divestitures, and strategic investments, and the integration of acquired companies or technologies or divestiture of businesses may negatively impact Brocade's business and financial results.***

Brocade has acquired—or made strategic investments in—other companies, products, or technologies, and Brocade may make additional acquisitions and strategic investments in the future. For example, in the third quarter of fiscal year 2016, Brocade acquired Ruckus. The ability of Brocade to realize the anticipated benefits of its acquisitions and strategic investments involves numerous risks, including, but not limited to, the following:

- The target market for the acquired products may not develop within the expected time frame or may evolve in a different technical direction;
- Difficulties in successfully integrating the acquired businesses and realizing any expected synergies, including failure to integrate successfully the sales organizations;
- Failure to communicate to customers the capabilities of the combined company;
- Unanticipated costs, litigation, and other contingent liabilities, including liabilities associated with acquired intellectual property;
- Diversion of management's attention from Brocade's daily operations and business;
- Adverse effects on existing business relationships with suppliers and customers, including delays or cancellations of customer purchases, as well as revenue attrition in excess of anticipated levels if existing customers alter or reduce their historical buying patterns;
- Risks associated with entering into markets in which Brocade has limited or no prior experience, including the potential for a lower level of understanding of specific market dynamics;
- Inability to attract and retain key employees;



- Inability to successfully develop new products and services on a timely basis to address the market opportunities of the combined company;
- Inability to compete effectively against companies already serving the broader market opportunities expected to be available to the combined company;
- Inability to qualify the combined company's products with OEM partners on a timely basis, or at all;
- Inability to successfully integrate financial reporting and IT systems;
- Inability to develop software-oriented back-office systems and processes necessary to sell and support a variety of software-based offerings;
- Failure to successfully manage additional business locations, including the infrastructure and resources necessary to support and integrate such locations;
- Assumption or incurrence of debt and contingent liabilities and related obligations to service such liabilities and potential limitations on Brocade's operations in order to satisfy financial and other negative operating covenants;
- Additional costs, such as increased costs of manufacturing and service; costs associated with excess or obsolete inventory; costs of employee redeployment, relocation, and retention, including salary increases or bonuses; accelerated amortization of deferred equity compensation, severance payments, reorganization, or closure of facilities; taxes; advisor and professional fees; and termination of contracts that provide redundant or conflicting services; and
- The impact of acquisition- and integration-related costs, goodwill or in-process research and development impairment charges, amortization costs for acquired intangible assets, and acquisition accounting treatment, including the loss of deferred revenue and increases in the fair values of inventory and other acquired assets, on Brocade's operating results and financial condition.

Risks associated with acquisitions can be more pronounced for larger and more complicated transactions. For example, Brocade completed its acquisition of Ruckus in May 2016. The size of the Ruckus acquisition increases both the scope and consequence of the ongoing risks and challenges associated with that acquisition. These risks are further exacerbated by the pending acquisition of Brocade by Broadcom and Broadcom's planned divestiture of Brocade's wireless and campus networking businesses, which include Ruckus, to ARRIS. Brocade may not successfully address those risks and challenges in a timely manner, or at all. If that occurs, Brocade may not fully realize all of the anticipated benefits of the Ruckus acquisition, and its revenue, expenses, operating results and financial condition could be adversely affected.

Brocade has in the past, and may in the future, also divest or reduce its investment in certain businesses or product lines from time to time. For example, during the third quarter of fiscal year 2017, Brocade completed the divestiture of its virtual router ("vRouter") product lines and signed purchase agreements to divest its virtual application delivery controller ("vADC") and virtual evolved packet core ("vEPC") product lines and, subsequent to the end of the third quarter of fiscal year 2017, Brocade completed the divestitures of its vADC, vEPC and software-defined networking ("SDN") controller product lines. Such divestitures involve risks, such as difficulty separating portions of or entire businesses, distracting employees, incurring potential loss of revenue, negatively impacting margins, and potentially disrupting customer relationships. Brocade may also incur significant costs associated with exit or disposal activities, related impairment charges, or both.

***Uncertainty about or a slowdown in the domestic and/or international economies has adversely affected, and may increasingly adversely affect, Brocade's operating results and financial condition.***

In recent years, the rate of economic growth in the United States has moderated and in certain other countries, including China, has significantly declined. In addition, uncertainty exists about the future growth of the domestic and international economies. Such uncertainty and slowdowns have resulted in, and may again result in, lower growth or a decline in IT-related spending, and, consequently, lead to lower growth or a decline in the networking market (including high-performance data networking solutions). Historically, IT spending has declined as general economic and market conditions have worsened due to geopolitical uncertainty. In addition, IT spending by international customers may decline if the value of the local currencies weaken against the U.S. dollar. Brocade is particularly susceptible to reductions in IT spending because the purchase of networking solutions is often discretionary and may involve a significant commitment of capital and other resources. The loss or delay of orders from any of Brocade's more significant customers, such as individual branches or agencies within the U.S. federal government, or customers within the service provider, financial services, education (including technology improvements for schools funded by the U.S. federal government commonly known as the E-Rate program), and health sectors, could also cause Brocade's revenue and profitability to suffer. For example, Brocade's revenue and operating results could be negatively impacted if the U.S. federal government experiences delays in procurement due to longer decision-making time frames and/or a shift in IT procurement priorities. Economic uncertainty has caused, and may cause further, reductions in Brocade's revenue, profitability, and cash flows, along with increased price competition, increased operating costs, and longer fulfillment cycles. Moreover, economic uncertainty may exacerbate many other risks noted elsewhere in this Form 10-Q, which could adversely affect Brocade's business operations and financial condition.

***Brocade's future revenue growth depends on its ability to successfully introduce and achieve market acceptance of new products, services, and support offerings on a timely basis.***

Developing new products, services, and support offerings requires significant upfront investments that may not result in revenues for an extended period of time, if at all. Brocade must achieve market acceptance of its new product and support offerings on a timely basis in order to realize the benefits of its investments. However, the market for networking solutions, driven in part by the growth and evolution of the Internet and adoption of new technologies, such as software-defined networking, network functions virtualization, and Wi-Fi-related cloud services, is characterized by rapidly changing technology, accelerated product introduction cycles, changes in customer requirements, and evolving industry standards. In addition, many of Brocade's new products, services, and support offerings will be directed toward customers, including hyperscale cloud providers and large service providers, with whom Brocade does not have strong existing sales relationships and who may require longer periods of time to evaluate products prior to making purchases. Sales to these customers may be challenging because sales are often based on long-term relationships and network incumbency and the complex system environments maintained by these customers often require interoperation with a variety of other vendors and back-office applications. Brocade's future success depends largely upon its ability to address the rapidly changing needs of both new and existing customers by: allowing connectivity to other devices and partnering effectively; keeping pace with technological developments and emerging industry standards; and delivering high-quality, reliable, and cost-effective products, product enhancements, and services and support offerings on a timely basis.

Other factors that may affect Brocade's successful introduction of new products, services, and support offerings include, but are not limited to, Brocade's ability to:

- Properly predict the market for new products, services, and support offerings, including features, cost-effectiveness, scalability, and pricing—all of which can be particularly challenging for initial product offerings in new markets;
- Differentiate Brocade's new products, services, and support offerings from its competitors' offerings;
- Address the interoperability complexities of Brocade's products with its OEM partners' server and storage products and Brocade's competitors' products;
- Determine which route(s) to market will be most effective; and
- Manage product transitions, including forecasting demand, managing excess and obsolete inventories, addressing product cost structures, and managing different sales and support requirements.

Failure to successfully introduce competitive products, services, and support offerings on a timely basis may harm Brocade's business and adversely affect Brocade's financial results.

***If Brocade is unable to successfully transition from older products and corresponding support and service offerings to new products and corresponding support and service offerings on a timely basis, its business and financial results could be adversely affected.***

As Brocade introduces new or enhanced products, such as Brocade's recently introduced Gen 6 Fibre Channel SAN platform and SLX line of routers and data center switches, it must successfully manage the transition from older products to minimize disruption in customers' ordering patterns, avoid excessive levels of older product inventories, maintain existing support revenue streams, and provide sufficient supplies of new products to meet customer demands. The introduction of new or enhanced products may shorten the life cycle of Brocade's existing products or replace the sales of some of Brocade's current products, thereby offsetting the benefit of a successful product introduction. When Brocade introduces new or enhanced products, it faces numerous risks related to product transitions, including the inability to accurately forecast demand, manage excess and obsolete inventories, address new or higher product cost structures, and manage different sales and support requirements due to the type or complexity of the new or enhanced products. In addition, customer evaluation periods or any customer uncertainty regarding the timeline for rolling out new products, or Brocade's plans for future support of existing products (for example, uncertainty created by Brocade's pending acquisition by Broadcom and Broadcom's planned divestiture of certain portions of Brocade's IP Networking business), may cause customers to delay purchase decisions or to purchase competing products, which would adversely affect Brocade's business and financial results.

***The prices of Brocade's IP Networking products have declined in the past and Brocade expects the prices of its products to decline in the future, which could reduce Brocade's revenues, gross margins, and profitability.***

The average selling price for Brocade's IP Networking products has typically declined in the past and will likely decline in the future as a result of competitive pricing pressures, broader macroeconomic factors, product mix, new product introductions by Brocade or competitors, the entrance of new competitors, and other factors. In particular, if economic conditions deteriorate and create a more cautious capital spending environment in the IT sector, Brocade and its competitors could pursue more aggressive pricing strategies in an effort to maintain or increase revenues. If Brocade is unable to offset a decline in the average selling price of Brocade's IP Networking products by increasing the volume of products shipped and/or reducing product manufacturing costs, including key components such as optics, Brocade's revenues, gross margins, and profitability could be adversely affected.

***Brocade's failure to execute on its overall sales strategy or successfully leverage its channel and direct sales capabilities could significantly reduce its revenues and negatively affect its business, financial results, and growth prospects.***

Brocade offers networking solutions through a multipath distribution strategy, including distributors, resellers, a direct sales force, and OEMs. However, Brocade's efforts to increase sales through this multipath distribution strategy may not generate incremental revenue opportunities. Several of Brocade's major OEM customers, including Dell EMC, IBM, and HPE, have acquired companies that offer IP Networking solutions that are competitive with Brocade offerings. A loss of, or significant reduction in, revenue through one of Brocade's paths to market would negatively impact its business and financial results.

As the networking industry continues to evolve, partners with which Brocade does not have long-standing relationships, such as cloud service providers that provide routing and infrastructure-as-a-service and global systems integrators that provide complete solutions to end users interested in upgrading to more modern architectures, may become increasingly important. In addition, as more enterprises purchase infrastructure-as-a-service offerings from hyperscale cloud providers and large service providers, sales through some of Brocade's existing paths to market could decline. If Brocade fails to build or grow successful relationships with these partners and service providers, Brocade's business and financial results could be adversely affected.

Brocade's failure to successfully develop new and/or maintain its current channel partner relationships, or the failure of these partners to successfully sell Brocade's products (for example, by devoting more resources to marketing and supporting Brocade's competitors' products and services), could reduce Brocade's growth prospects significantly. In addition, Brocade's ability to respond to the needs of its distribution and reseller partners in the future may also depend on third parties producing complementary products and applications for Brocade products to enable these partners to be competitive in the market. In addition, Brocade may not successfully achieve its expanded go-to-market objectives, which include effectively maintaining or expanding sales through its distribution channels, successfully managing distribution and reseller partner relationships, and effectively training and incentivizing its channel partners. If Brocade fails to respond successfully to the needs of these distribution and reseller partners and their customers, Brocade's business and financial results could be adversely affected.

***If Brocade does not manage the risks associated with its wireless networking business properly, its revenue and profitability could be adversely affected.***

As described below, certain risks that accompany Brocade's new wireless networking business differ from those of Brocade's other businesses.

The success of Brocade's wireless networking business depends on the continued growth and reliance on Wi-Fi, particularly in the service provider and enterprise markets. The recent growth of the market for Wi-Fi networks is being driven by the increased use of Wi-Fi-enabled mobile devices and the use of Wi-Fi as a preferred connectivity option to support video, voice, and other higher-bandwidth uses. As a result, mobile service providers and enterprises are struggling to address the increasing capacity demands. A number of barriers may prevent service providers or their subscribers from adopting Wi-Fi technology to address the wireless network capacity gap. For example, Wi-Fi operates over an unlicensed radio spectrum, and if the Wi-Fi spectrum becomes crowded, Wi-Fi solutions will be a less attractive option for service providers. In addition, in order for Wi-Fi solutions to adequately address the capacity gap, mobile devices should automatically switch from a cellular data network to the service provider's Wi-Fi network, when available and appropriate, which does not generally occur. There is no guarantee that service providers and enterprises will continue to utilize Wi-Fi technology, that use of Wi-Fi-enabled mobile devices will continue to increase, or that Wi-Fi will continue to be the preferred connectivity option for the uses described above. If another technology were found to be superior to Wi-Fi by service providers or enterprises, it could adversely affect Brocade's revenue and profitability.

Brocade's wireless products are designed to interoperate with cellular networks and mobile devices using Wi-Fi technology. These networks and devices have varied and complex specifications. As a result, Brocade must attempt to ensure that its products interoperate effectively with all of these existing and planned networks and devices. To meet these requirements, Brocade must continue to undertake development and testing efforts that require significant capital and employee resources. Brocade may not accomplish these development efforts quickly or cost-effectively, or at all. If Brocade's wireless products do not interoperate effectively, orders for Brocade's wireless products could be delayed or cancelled, potentially resulting in the loss of existing and potential end customers; Brocade could experience significant warranty, support and repair costs; and the attention of Brocade's engineering personnel could be diverted from its product development efforts. In addition, Brocade's end customers may require Brocade's products to comply with new and rapidly evolving security or other certifications and standards. If Brocade's wireless products are late in achieving or fail to achieve compliance with these certifications and standards, and/or if Brocade's competitors achieve compliance with these certifications and standards, such end customers may not purchase Brocade's products, which would adversely affect Brocade's revenue and profitability.

Brocade's wireless products have been deployed in many different locations and user environments and are capable of providing connectivity to many different types of Wi-Fi-enabled devices operating a variety of applications. The ability of Brocade's wireless products to operate effectively can be negatively impacted by many different elements unrelated to its products. For example, a user's experience may suffer from an incorrect setting in a Wi-Fi device. Although certain technical problems experienced by users may not be caused by Brocade's products, users often perceive the underlying cause to be a result of poor performance of the wireless network. This perception, even if incorrect, could harm Brocade's business and reputation.

***If Brocade loses key employees or is unable to hire additional qualified employees, its business may be negatively impacted.***

Brocade's success depends, to a significant degree, upon the continued contributions of its employees, including executive officers, engineers, sales representatives, and others, many of whom would be difficult to replace. Departures, appointments, and changes in roles and responsibilities of officers or other key members of management may disrupt Brocade's business and adversely affect Brocade's operating results.

Brocade believes its future success depends, in large part, upon its ability to attract highly skilled employees and operate effectively in geographically diverse locations. Brocade has relied heavily on equity awards in the form of stock options and restricted stock units as one means for recruiting and retaining highly skilled employees. The effectiveness of these equity awards in recruiting and retaining employees could be reduced if Brocade has to reduce the size of the equity awards granted to its employees or if there is a sustained decline in the trading price of Brocade's shares. There are also limited qualified employees in each of Brocade's markets, and competition for such employees is very aggressive. In particular, Brocade operates in various locations with highly competitive labor markets, including Bangalore, India, and San Jose, California. Brocade may experience difficulty in hiring key management and qualified employees with skills in nearly all areas of Brocade's business and operations.

The loss of the services of any of Brocade's key employees, the inability to attract or retain qualified employees in the future, or delays in hiring required employees—particularly sales and engineering employees—could delay the development and introduction of Brocade's products or services and/or negatively affect its ability to sell products or services.

In addition, the pending acquisition of Brocade by Broadcom, and Broadcom's planned divestiture of certain portions of Brocade's IP Networking business, have had and may continue to have an adverse effect on Brocade's ability to retain and motivate current employees or attract and retain prospective employees, each of whom may be uncertain about their future roles and relationships following the completion of the transactions. Further, Brocade's ability to change compensation or take other actions to retain employees is limited under the merger agreement. Attrition of Brocade's employees will likely have an adverse effect on Brocade's business.

***Brocade has a substantial amount of acquired intangible assets, goodwill, and deferred tax assets on its balance sheet, and if Brocade is required to record impairment charges for these assets, such impairment charges could adversely affect Brocade's financial results.***

Brocade has a substantial amount of acquired intangible assets and goodwill on its balance sheet related to Brocade's prior acquisitions. Brocade's determination of the fair value of its long-lived assets relies on management's assumptions of future revenues, operating costs, and other relevant factors. Brocade's estimates with respect to the useful life or ultimate recoverability of Brocade's carrying basis of assets, including acquired intangible assets, could change as a result of changes in strategic focus, competition, or other changes affecting management's assumptions. If management's estimates of future operating results change or if there are changes to other assumptions, such as the discount rate applied to future cash flows, then the estimated fair value of Brocade's reporting units could change significantly, which could result in goodwill impairment charges. The risk of a future goodwill impairment charge is comparatively high for the IP Networking Products reporting unit because, based on the Company's fiscal year 2016 annual goodwill impairment test, the estimated fair value of that reporting unit's net assets, which include goodwill, exceeded the carrying value of those net assets by only approximately \$181 million. For a sensitivity analysis that quantifies the impact of certain key assumptions used by Brocade on the fair value estimates for the IP Networking Products reporting unit, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates" in Part I, Item 2 of this Form 10-Q. If future impairment tests should result in a charge to earnings, Brocade's financial results would be adversely affected.

Brocade has determined that, more likely than not, it will realize its deferred tax assets based on positive evidence of its historical operations and projections of future income, except for the deferred tax assets related to California and remaining capital loss carryforwards for which a valuation allowance has been applied. In the event that future income by jurisdiction is less than what is currently projected, Brocade may be required to apply a valuation allowance to these deferred tax assets in jurisdictions where realization of such assets is no longer more likely than not, which could result in a charge to earnings that would adversely affect Brocade's financial results.

***Cyberattacks and data security breaches could disrupt Brocade's operations, negatively impact Brocade's reputation, and erode customers' trust.***

Cyberattacks and other malicious attacks could lead to data breaches, computer break-ins, malware, viruses, and unauthorized tampering with Brocade's computer systems, intellectual property, and confidential information of its customers and partners. These attacks could disrupt Brocade's operations, negatively impact Brocade's reputation, and erode customers' trust. Brocade's IT systems also rely in part upon certain business management and communication tools provided by third-party vendors, and security flaws or outages in such tools could adversely affect Brocade's operations. Despite implementation of cybersecurity measures by Brocade and its third-party vendors, Brocade or such vendors may not successfully limit attacks by malicious third parties if they attempt to undermine or disrupt those cybersecurity measures.

Additionally, if an actual or perceived cyberattack or data security breach occurs in Brocade's network or in one of Brocade's customers' networks, regardless of whether the breach is attributable to Brocade's products, the market perception of the effectiveness of Brocade's products could be harmed. Brocade may suffer reputational harm and Brocade's customers' trust may be eroded as a result of a data security breach involving customers' or employees' information, which could negatively impact revenue, expenses, and profitability. Customers have become increasingly sensitive to government-sponsored surveillance and may believe that, as a U.S.-based manufacturer, Brocade's equipment contains "backdoor" code that would allow customer data to be compromised by either governmental bodies or other third parties. As a result, customers may choose not to deploy Brocade networking products, which could negatively impact Brocade's business and financial results.



***Brocade's revenues, operating results, and cash flows may fluctuate from period to period due to a number of factors, which makes predicting financial results difficult.***

IT spending is subject to cyclical and uneven fluctuations, which could cause Brocade's financial results to fluctuate unevenly and unpredictably. For example, the U.S. federal budget for government IT spending can be highly seasonal and subject to delays, reductions, and uncertainty due to changes in the political and legislative environment. It can also be difficult to predict the degree to which end-customer demand and the seasonality and uneven sales patterns of Brocade's OEM partners or other customers will affect Brocade's business in the future, particularly as Brocade releases new or enhanced products. While Brocade's first and fourth fiscal quarters are typically stronger quarters for SAN products and Brocade's third and fourth fiscal quarters are typically stronger quarters for IP Networking solutions, future buying patterns may differ from historical seasonality. If the mix of revenue changes, it may also cause results to differ from historical seasonality. Accordingly, Brocade's quarterly and annual revenues, operating results, cash flows, and other financial and operating metrics may vary significantly in the future, and the results of any prior periods should not be relied upon as an indication of future performance. In addition, the announcement and pendency of Brocade's agreement to be acquired by Broadcom, Broadcom's planned divestiture of certain portions of Brocade's IP Networking business, or the failure to complete the proposed transactions on a timely basis or at all, could have a material adverse effect on, and cause fluctuations in, Brocade's operating results.

***Failure to accurately forecast demand for Brocade's products or to successfully manage the production of its products could increase Brocade's product cost and adversely affect its revenue, margins and profitability.***

Brocade provides product forecasts to its contract manufacturers ("CMs") and places purchase orders with them in advance of the scheduled delivery of products to Brocade's customers. In preparing sales and demand forecasts, Brocade relies largely on input from its sales force, partners, resellers, and end-user customers. If Brocade is unable to accurately forecast demand, or if Brocade fails to effectively communicate with its distribution partners about end-user demand or other time-sensitive information, Brocade's ability to successfully manage production could be negatively impacted. Brocade's ability to accurately forecast demand also may become increasingly limited as Brocade introduces new or enhanced products, begins phasing out certain products, or acquires other companies or businesses. Further, the announcement and pendency of Broadcom's proposed acquisition of Brocade and planned divestiture of certain portions of Brocade's IP Networking business increase the challenge of accurately forecasting customer demand. If these forecasts are inaccurate, Brocade may be unable to obtain adequate manufacturing capacity from its CMs to meet customers' delivery requirements, which could cause customers to cancel their orders for Brocade products. Inaccurate forecasts also could cause Brocade to accumulate excess inventories or incur costs associated with excess manufacturing capacity. If customers cancel their orders, Brocade's revenue may be adversely affected. If excess inventories accumulate, Brocade's gross margins may be negatively impacted by write-downs for excess and/or obsolete inventory. In addition, Brocade will experience higher fixed costs as it expands its CMs' capabilities for forecasted demand, which could negatively affect Brocade's margins if demand decreases suddenly and Brocade is unable to reduce these fixed costs.

Additionally, most of Brocade's manufacturing overhead and expenses are fixed in the short term or incurred in advance of receipt of corresponding revenue, and Brocade may not be able to reduce such expenses sufficiently to offset declining product prices, reduced volumes, or other factors. As a result, Brocade's gross margins may be adversely affected by fluctuations in manufacturing volumes, component costs, foreign currency exchange rates, the mix of product configurations sold, and the mix of distribution channels through which its products are sold. Brocade's gross margins may also be adversely affected if product or related warranty costs associated with Brocade's products are greater than previously experienced.

***Brocade has extensive international operations, which expose its business and operations to additional risks.***

Brocade has significant international operations, and a significant portion of Brocade's sales occur in international jurisdictions. In addition, Brocade's CMs have significant operations in China and other locations outside the United States. Brocade's international sales of its IP Networking solutions have primarily depended on its distributors and resellers. Maintenance or expansion of international sales or international operations involves inherent risks that Brocade may not be able to control, including, but not limited to, the following:

- Compliance by Brocade and its channel partners and other agents with numerous and often complex U.S. and other applicable government regulations prohibiting certain end-uses and restricting trade with embargoed or sanctioned countries, such as Iran and Russia, and with denied parties;
- Difficulty in conducting due diligence with respect to business partners in certain international markets;

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- Exposure to economic instability or fluctuations in international markets, such as China, that could cause reductions in IT spending;
- Exposure to inflationary risks and/or wage inflation in certain countries, such as India;
- Increased exposure to foreign currency exchange rate fluctuations, including currencies such as the British pound, the Chinese yuan, the euro, the Indian rupee, the Japanese yen, the Singapore dollar, and the Swiss franc;
- Exposure to sovereign debt risk and political and economic instability in certain regions of Europe, including Russia and Turkey, and certain countries with newly advanced economies, including China and Brazil;
- Multiple potentially conflicting and changing governmental laws, regulations, technical standards, certification requirements, and practices, including differing environmental, data privacy, export, import, trade, manufacturing, product compliance, tax, labor, and employment laws;
- Compliance by Brocade and its channel partners and other agents with the numerous and often complex U.S. and other applicable government regulations relating to exports and imports, and associated licensing requirements, particularly in the area of encryption technology;
- Reduced or limited protection of intellectual property rights, particularly in jurisdictions that have less-developed intellectual property regimes, such as China and India;
- Commercial laws and business practices that favor local competition;
- In certain international regions, particularly those with rapidly developing economies, it may be common to engage in business practices that are prohibited by anti-bribery laws, such as the U.S. Foreign Corrupt Practices Act and the U.K. Bribery Act;
- Increased complexity, time, and costs of managing international operations;
- Managing research and development and sales teams in geographically diverse locations, including teams divided between the United States, the United Kingdom, and India;
- Effective communications across multiple geographies, cultures, and languages;
- Recruiting sales and technical support personnel with the skills to design, manufacture, sell, and support Brocade's products in international markets;
- Longer sales cycles and manufacturing lead times;
- Increased complexity and cost of providing customer support and maintenance for international customers;
- Difficulties in collecting accounts receivable;
- Increased complexity of logistics and distribution arrangements; and
- Increased complexity of accounting rules and financial reporting requirements.

In addition, the June 2016 announcement of the results of the United Kingdom European Union membership referendum (commonly referred to as "Brexit") advising for the exit of the United Kingdom from the European Union has created economic, financial, and regulatory uncertainty, which may cause Brocade's customers to closely monitor their costs and reduce their spending on Brocade's products and services.

Any of these factors could negatively impact Brocade's business, revenues, and profitability.

***If product orders are received late in a fiscal quarter, Brocade may be unable to recognize revenue for these orders in the same quarter, which could adversely affect quarterly financial results.***

Brocade's IP Networking business typically experiences significantly higher levels of customer orders toward the end of a fiscal period. Customer orders received toward the end of the period may not ship within the period due to a lack of available inventory and manufacturing lead times. The inability to ship within the quarter in which the customer orders are received could negatively impact Brocade's financial results in a particular quarter.



***Brocade is subject to—and will continue to be subject to—intellectual property infringement claims and litigation that are costly to defend and/or settle, which could result in significant damages and other costs to Brocade and limit Brocade's ability to use certain technologies in the future.***

Brocade competes in markets in which companies are frequently subject to claims and related litigation regarding patent and other intellectual property rights. Third parties have, from time to time, asserted patent, copyright, trade secret, and/or other intellectual property-related claims against Brocade and/or employees of Brocade. These claims may be, and have in the past been, made against Brocade's products and services, subcomponents of its products, methods performed by its products or a combination of products, including third-party products, methods used in its operations, or uses of its products by its customers. The claimant may seek various remedies against Brocade, such as money damages, disgorgement of profits, injunctions barring sales of infringing goods, or exclusion orders barring import of products into the U.S., among other possible remedies. Moreover, these claims may concern Brocade's hiring of a former employee of the third-party claimant. Brocade and companies acquired by Brocade have in the past incurred, and will likely incur in the future, substantial expenses to defend against such third-party claims. In particular, as a result of the acquisition of Ruckus, Brocade now competes in new markets, including the Wireless LAN market, that may result in relatively greater numbers of third-party intellectual property claims. Brocade's suppliers and customers also may be subject to third-party intellectual property claims with respect to their own products, which could negatively impact the suppliers' ability to supply Brocade with components or customers' willingness to purchase products from Brocade. In addition, Brocade may be subject to claims, defenses, and indemnification obligations with respect to third-party intellectual property rights pursuant to Brocade's agreements with suppliers, OEM and channel partners, or customers. If Brocade refuses to indemnify or defend such claims, for instance, even in situations in which the allegations are meritless, then suppliers, partners, or customers may refuse to do business with Brocade. Parties that assert such intellectual property claims may be unreasonable in their demands, or may simply refuse to settle, which could lead to prolonged periods of litigation, additional burdens on employees or other resources, distraction from Brocade's business operations, component supply stoppages, expensive settlement payments, and lost sales. Furthermore, there is little or no information publicly available concerning market or fair values for licenses and/or settlement fees, which can lead to overpayment of license or settlement fees. Any of the above scenarios could have an adverse effect on Brocade's financial position, financial results, cash flows, and future business prospects.

***Undetected software or hardware errors could increase Brocade's costs, reduce its revenues, and delay market acceptance of its products.***

Networking products frequently contain undetected software or hardware errors when first introduced or as new versions are released. The software incorporated into Brocade's product portfolio may include software licensed from third parties and errors may be found from time to time in these products. In addition, through its acquisitions, Brocade has assumed—and may in the future assume—products previously developed by an acquired company that have not been through the same level of product development, testing, and quality control processes used by Brocade, and may have known and/or undetected errors. Some types of errors may not be detected until the product is installed in a user environment. In addition, Brocade products are often combined with other products, including software from other vendors, and these products often need to interoperate. For IT products that have different specifications, utilize multiple protocol standards, or may be procured from other vendors, it may be difficult to identify the source of any problems. Identifying the source of and remediating these problems may cause Brocade to incur significant warranty and repair costs, divert the attention of engineering personnel from product development efforts, and cause significant customer relations problems, resulting in lower profitability from increased costs and/or decreased revenue. Moreover, the occurrence of hardware and software errors, whether caused by Brocade products or another vendor's products, could delay market acceptance of new or enhanced Brocade products.

***Brocade's supply chain is dependent on several sole-source and limited-source suppliers and a limited number of major CMs, either one or both of which may significantly impact Brocade's financial results.***

Although Brocade uses standard parts and components for its products where possible, Brocade's CMs currently purchase, on Brocade's behalf, several key components used in the manufacture of its products from single- or limited-source suppliers. Brocade's single-source components include, but are not limited to, its application-specific integrated circuits (commonly referred to as "ASICs") and its Wi-Fi chipsets. Brocade's principal limited-source components include memory, certain oscillators, microprocessors, certain connectors, certain logic chips, power supplies, programmable logic devices, printed circuit boards, certain optical components, packet processors, and switch fabric components. Brocade generally acquires these components through purchase orders and has no long-term commitments regarding supply or pricing with such suppliers. If Brocade is unable to obtain these and other components when required, or if Brocade's suppliers experience component defects, Brocade may not be able to deliver its products to customers in a timely manner and may be required to repair or retrofit products previously delivered to customers, at significant expense to Brocade. In addition, a challenging economic or industry environment could cause some of these sole-source or limited-source suppliers to delay or halt production, go out of business, or be acquired by third parties, which could result in a disruption in Brocade's supply chain. Brocade's supply chain could also be disrupted in a variety of other circumstances that may impact its suppliers and partners, including adverse results from intellectual property litigation or natural disasters. Any manufacturing disruption by these sole-source or limited-source suppliers could severely impair Brocade's ability to fulfill orders and may significantly impact its financial results.

In addition, the loss of any of Brocade's major CMs, or portions of their capacity, could significantly impact Brocade's ability to produce its products for an indefinite period of time. Qualifying a new CM and commencing volume production is typically a lengthy and expensive process. A CM may move the production lines for Brocade's products to new locations or factories, and this may result in delays or disruptions. If Brocade changes any of its CMs or if any of its CMs experience unplanned delays, disruptions, capacity constraints, component parts shortages, or quality control problems in their manufacturing operations, shipment of Brocade's products to customers could be delayed and result in loss of revenues.

***Brocade's intellectual property rights may be infringed upon or misappropriated by others, and Brocade may not be able to protect or enforce its intellectual property rights.***

Brocade's intellectual property rights may be infringed upon or misappropriated by others, including by competitors, partners, former employees, foreign governments, or other third parties. In some cases, such infringement or misappropriation may be undetectable, or enforcement of Brocade's intellectual property rights may be impractical. Brocade has filed, and may in the future file, lawsuits against third parties in an effort to enforce its intellectual property rights. Intellectual property litigation is expensive and unpredictable. There can be no assurance that Brocade will prevail in such assertions or enforcement efforts, either on the merits, or with respect to particular relief sought, such as damages or an injunction. Nor can there be any assurance that any awarded damages ultimately will be paid to Brocade. Furthermore, the opposing party may attempt to prove that the asserted intellectual property rights are invalid or unenforceable, and, if successful, may seek recompense for its attorneys' fees and costs or countersue Brocade as part of its defense. Finally, there can be no assurance that any attempt by Brocade to enforce its intellectual property rights, even if successful in court, will improve Brocade's sales, diminish the defendant's sales, or stop the defendant's allegedly unfair competition.

Brocade relies on a combination of patent, copyright, trademark, and trade secret laws, along with measures such as physical and operational security and contractual restrictions, to protect its intellectual property rights in its proprietary technologies, but none of these methods of protection may be entirely appropriate or adequate to address all risks that could result in a loss of intellectual property rights. Loss or violation of Brocade's intellectual property rights could adversely affect Brocade's business and operating results through a loss of revenue or an increase in expenses.

***Brocade relies on licenses from third parties, and the loss or inability to obtain any such license could adversely affect its business.***

Many Brocade products are designed to include software or other intellectual property licensed from third parties. There can be no assurance that the necessary licenses will be available on acceptable terms, if at all. Brocade's inability to obtain certain licenses or other rights on favorable terms, or the termination of existing licenses, could have an adverse effect on Brocade's business, operating results, and financial condition, including its ability to continue to distribute or support affected products.

In addition, if Brocade has failed, or in the future fails, to adequately manage the use of commercial or “open-source” software in Brocade’s products, or if companies acquired by Brocade fail in such regard, Brocade may be subject to copyright infringement litigation or other claims. Furthermore, Brocade may be required, for commercially licensed software, to pay penalties or undergo costly audits pursuant to the license agreement. In the case of open-source software, Brocade may be required to license proprietary portions of its products on a royalty-free basis, disclose proprietary parts of source code, or commence costly product redesigns that could result in a loss of intellectual property rights, product performance degradation, or a delay in shipping products to customers and result in loss of revenue or increased costs.

***Brocade’s planned upgrade of its enterprise resource planning (“ERP”) software solution could result in significant disruptions to its operations.***

Brocade is in the process of upgrading its ERP software solution to a newer version. Brocade expects the upgrade to be completed in the first half of fiscal year 2018. Implementation of the upgraded solution will have a significant impact on Brocade’s business processes, information systems, and internal controls. The transition will require significant change management, meaningful investment in capital and personnel resources, and coordination of numerous software and system providers and internal business teams. Brocade may experience difficulties as it manages these changes and transitions to the upgraded systems and processes, including loss or corruption of data, delayed shipments, decreases in productivity as its personnel implement and become familiar with new systems and processes, unanticipated expenses (including increased costs of implementation or costs of conducting business), and lost revenues. Difficulties in implementing the upgraded solution or significant system failures could disrupt Brocade’s operations, divert management’s attention from key strategic initiatives, and have an adverse effect on its capital resources, financial condition, results of operations, or cash flows. In addition, any delays in completing the upgrade process, including any delays associated with Broadcom’s proposed acquisition of Brocade, could exacerbate these transition risks as well as expose Brocade to additional risks in the event that the support for Brocade’s existing ERP software solution is reduced or eliminated.

***Business interruptions could adversely affect Brocade’s business operations.***

Brocade’s business operations and the operations of its suppliers, CMs, and customers are vulnerable to interruptions caused by acts of terrorism, fires, earthquakes, tsunamis, nuclear reactor leaks, hurricanes, power losses, telecommunications failures, and other events beyond Brocade’s control. For example, a substantial portion of Brocade’s facilities, including its corporate headquarters, are located near major earthquake faults. Brocade does not have multiple-site capacity for all of its services in the event of a business disruption. In the event of a major earthquake, Brocade could experience business interruption resulting from destruction of facilities or other infrastructure and from loss of life. Brocade does not carry earthquake insurance and has not set aside funds or reserves to cover potential earthquake-related losses. Additionally, major public health issues, such as an outbreak of a pandemic or epidemic, may interrupt business operations of Brocade, its CMs, its customers, or its suppliers in those geographic regions affected by that particular health issue. In addition, one of Brocade’s CMs has a major facility located in an area that is subject to hurricanes, and Brocade’s suppliers could face other natural disasters, such as floods, earthquakes, extreme weather, and fires. In the event that a business interruption occurs that affects Brocade, its suppliers, CMs, or customers, shipments could be delayed or cancelled, and Brocade’s business operations and financial results could be harmed.

In addition, Brocade may suffer reputational harm and may not carry sufficient insurance to compensate for financial losses that may occur as a result of any of these events. Any such event could have an adverse effect on Brocade’s business, operating results, and financial condition, and could expose Brocade to significant third-party claims of liability and damages.

***Brocade is required to assess its internal control over financial reporting on an annual basis, and any adverse findings from such assessment could result in a loss of investor confidence in its financial reports and significant expense to remediate any internal control deficiencies, and ultimately could have an adverse effect on its stock price.***

Brocade is required to assess the effectiveness of its internal control over financial reporting annually, as required by Section 404 of the Sarbanes-Oxley Act of 2002. Brocade’s evaluation of the effectiveness of its internal control over financial reporting as of October 29, 2016, its most recent internal control effectiveness evaluation date, did not include the internal control over financial reporting of Ruckus, a company that Brocade acquired in May 2016. Even though, as of October 29, 2016, Brocade concluded that its internal control over financial reporting was effective, Brocade needs to maintain its processes and systems and adapt them as its business grows and changes, including to reflect its integration of Ruckus, as well as any future acquisitions Brocade may undertake. This continuous process of maintaining and adapting its internal controls and complying with Section 404 is expensive, time consuming, and requires significant management attention. In addition, Brocade cannot be certain that its internal control measures will continue to provide adequate control over its financial processes and reporting or ensure compliance with Section 404.



If Brocade or its independent registered public accounting firm identifies material weaknesses in Brocade's internal controls, the disclosure of that fact, even if quickly remedied, may cause investors to lose confidence in Brocade's financial statements and its stock price may decline. Remediation of a material weakness could require Brocade to incur significant expenses and, if Brocade fails to remedy any material weakness, its financial statements may be inaccurate, its ability to report its financial results on a timely and accurate basis may be adversely affected, its access to the capital markets may be restricted, its stock price may decline, and Brocade may be subject to sanctions or investigation by regulatory authorities, including the U.S. Securities and Exchange Commission ("SEC") or the NASDAQ Stock Market LLC ("NASDAQ"). Brocade may also be required to restate its financial statements from prior periods.

***Brocade's business is subject to increasingly complex and changing legal and regulatory requirements that could adversely affect its business, financial results, and stock price.***

Brocade is subject to the changing rules and regulations of federal and state governments, as well as the stock exchange on which Brocade's common stock is listed. These entities, including the Public Company Accounting Oversight Board, the Financial Accounting Standards Board, the SEC, the Internal Revenue Service (the "IRS"), the Financial Industry Regulatory Authority, Inc., and NASDAQ, have issued a significant number of new regulations over the last several years and continue to develop additional regulations and requirements. Further, Brocade is subject to various rules and regulations of certain foreign jurisdictions. Brocade's efforts to comply with these requirements have resulted in, and are likely to continue to result in, an increase in expenses and a diversion of management's time from other business activities.

For example, the Dodd-Frank Wall Street Reform and Consumer Protection Act requires that public companies disclose whether certain minerals, commonly known as "conflict minerals," are necessary to the functionality or production of a product manufactured or contracted to be manufactured by those companies, and, if so, whether those minerals originated in the Democratic Republic of the Congo or an adjoining country. These requirements could adversely affect (i) Brocade's revenues, if its partners or customers are dissatisfied with Brocade's use or efforts to reduce the use of conflict minerals and (ii) the sourcing, availability, and pricing of minerals used in the manufacture of certain components that are incorporated in Brocade products. In addition, Brocade's supply chain is complex, so Brocade may face reputational challenges with its partners, customers, stockholders, and other stakeholders if the origins of the conflict minerals used in its products cannot be sufficiently verified.

Similarly, Brocade is subject to environmental and other regulations governing product safety, materials usage, packaging, and other environmental impacts in the countries where Brocade products are sold. For example, many Brocade products are subject to laws and regulations that restrict the use of certain substances such as lead, mercury, hexavalent chromium, and cadmium, and that require Brocade to assume responsibility for collecting, treating, recycling, and disposing of products when they have reached the end of their useful lives. For example, in Europe, environmental restrictions apply to products sold in that region, and certain Brocade partners require compliance with these or other more stringent requirements. In addition, recycling, labeling, and related requirements apply to Brocade products sold in Europe and China. If Brocade products do not comply with local environmental laws, Brocade could be subject to fines, civil and criminal sanctions, and contract damage claims. In addition, Brocade could be prohibited from shipping noncompliant products into certain jurisdictions and required to recall and replace any noncompliant products already shipped, which would disrupt Brocade's ability to ship products and result in reduced revenue, increased warranty expense, increased obsolete or excess inventories, and harm to Brocade's business and customer relationships.

Brocade's wireless products are subject to governmental regulations in a variety of jurisdictions. In order to achieve and maintain market acceptance, Brocade's wireless products must continue to comply with these regulations, as well as a significant number of industry standards. In the United States, Brocade's products must comply with various regulations defined by the Federal Communications Commission ("FCC"), Underwriters Laboratories, and others. Brocade must also comply with similar international regulations. For example, Brocade's wireless communication products operate through the transmission of radio signals, and radio emissions are subject to regulation in the United States and in other countries in which Brocade does business. In the United States, various federal agencies including the Center for Devices and Radiological Health of the United States Food and Drug Administration, the FCC, the Occupational Safety and Health Administration, and various state agencies have promulgated regulations that concern radio/electromagnetic emissions standards. Member countries of the European Union have enacted similar standards concerning electrical safety and electromagnetic compatibility and emissions, as well as chemical substances and use standards. As these regulations and standards evolve, and if new regulations or standards are implemented, Brocade will be required to modify its products or develop and support new versions of its products, and Brocade's compliance with these regulations and standards may become more burdensome. The failure of Brocade's wireless products to comply, or delays in compliance, with the various existing and evolving industry regulations and standards could prevent or delay introduction of Brocade's products, which could harm Brocade's business. End-customer uncertainty regarding future policies may also affect demand for communications products, including Brocade's wireless products. If existing laws or regulations regarding the use of Brocade's wireless products or related services are enforced in a manner not contemplated by Brocade's end customers, it could expose them or Brocade to liability and adversely affect Brocade's wireless networking business. Moreover, channel partners or end customers may require Brocade, or Brocade may otherwise deem it necessary or advisable, to alter its wireless products to address actual or anticipated changes in the regulatory environment. Brocade's inability to alter its wireless products to address these requirements and any regulatory changes may adversely affect Brocade's wireless networking business.

Brocade is subject to laws, rules, and regulations in the United States and other countries relating to the collection, use, and security of personal information and data. Brocade has incurred, and will continue to incur, expenses to comply with privacy and security standards, protocols, and obligations imposed by applicable laws, regulations, industry standards, and contracts. In addition, such data privacy laws, regulations, and other obligations may negatively impact Brocade's ability to execute transactions and pursue business opportunities. Brocade's customers may also be subject to such laws and regulations in their use of certain Brocade products and services to collect, store, and process data that may include personal information. Such customers may demand or request additional functionality in Brocade's products and services that they believe are necessary or appropriate to comply with such laws and regulations, which could cause Brocade to incur significant additional costs or lose business, or which could delay or impede the development of new solutions. The privacy and data protection-related laws, rules, and regulations applicable to Brocade and its customers are also subject to significant change. For example, in October 2015, the Court of Justice of the European Union invalidated a safe harbor framework that allowed Brocade and other U.S. companies to meet certain European legal requirements for transferring personal data from Europe to the United States. In response to this development, Brocade and many of its foreign subsidiaries have entered into an Intra-Group Data Transfer Agreement to enable the transatlantic transfer of employee and customer data. In April 2016, the European Parliament approved the General Data Protection Regulation. This regulation, when effective in May 2018, will impose more stringent data protection requirements on U.S. companies collecting personal data from European Union residents and establish greater penalties for noncompliance. Brocade is in the process of evaluating its business practices to ensure compliance with the General Data Protection Regulation. Any inability to comply with applicable privacy or data protection laws, regulations, or other obligations could result in significant cost and liability, damage Brocade's reputation, and adversely affect its business.

***Changes to Brocade's provision for income taxes or unfavorable outcomes of tax audits could adversely impact Brocade's financial condition or results.***

Brocade is subject to income and other taxes in the United States, including those required by both state and federal governmental agencies, such as the IRS, and numerous foreign jurisdictions. Brocade's provision for income taxes could be increased due to changes in tax laws in the jurisdictions in which Brocade does business, including an increase in tax rates or an adverse change in the treatment of an item of income or expense. In this regard, the United States, countries in the European Union, and other countries where Brocade operates have enacted or are proposing changes to relevant tax, accounting, and other laws, regulations, and interpretations, including fundamental changes to tax laws applicable to multinational corporations. In addition, future effective tax rates could be subject to volatility or adversely affected by changes in the geographic mix of earnings in countries with differing statutory rates, changes in the valuation of deferred tax assets and liabilities, and tax effects of stock-based compensation. These potential changes could increase Brocade's effective tax rate or result in other costs in the future.

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Brocade is subject to periodic audits or other reviews by such governmental agencies, and is currently under examination by several state and foreign tax jurisdictions for various years. Audits by governmental tax agencies are subject to inherent uncertainties and could result in unfavorable outcomes, including potential fines or penalties. While Brocade regularly assesses the likely outcomes of these audits in order to determine the appropriateness of its tax provision, the occurrence of an unfavorable outcome in any specific period could have an adverse effect on Brocade's financial condition or results for that period or future periods. The expense of defending and resolving such an audit may be significant.

***Brocade is exposed to various risks related to legal proceedings or claims that could adversely affect its financial condition or results.***

Brocade is a party to lawsuits in the normal course of its business. The results of complex legal proceedings are difficult to predict. Responding to lawsuits brought against Brocade, or legal actions initiated by Brocade, can often be expensive, time-consuming, and disruptive to normal business operations. Unfavorable outcomes from these claims and/or lawsuits could adversely affect Brocade's business, financial results, or financial condition, and Brocade could incur substantial monetary liability and/or be required to change its business practices. In view of the uncertainties, potential risks, and expenses of litigation, Brocade may, from time to time, settle such disputes, even where Brocade had meritorious claims or defenses, by agreeing to settlement agreements that, depending on their terms, may significantly impact Brocade's financial condition or results. Additional information regarding certain legal proceedings in which Brocade is currently engaged is discussed under "Legal Proceedings" in Part II, Item 1 of this Form 10-Q and in Note 9, "Commitments and Contingencies," of the Notes to Condensed Consolidated Financial Statements in Part I, Item 1 of this Form 10-Q.

***Brocade's stock price may fluctuate, which could cause the value of an investment in Brocade's shares to decline.***

Brocade's stock price has fluctuated in the past and may be subject to wide fluctuations in the future in response to various factors. Brocade does not have the ability to influence or control many of these factors. In addition to the factors discussed elsewhere in this "Risk Factors" section, factors that could affect Brocade's stock price include, among others:

- The failure of the pending acquisition of Brocade by Broadcom to be completed on a timely basis or at all;
- Speculation, coverage, or sentiment in the media or investment community regarding the likelihood of completion of the pending acquisition of Brocade by Broadcom;
- Public announcements regarding the status of the pending acquisition of Brocade by Broadcom and/or the status of Broadcom's planned divestiture of certain portions of Brocade's IP Networking business;
- Actual or anticipated changes in Brocade's operating results;
- Whether Brocade's operating results or forecasts meet the expectations of securities analysts or investors;
- Actual or anticipated changes in the expectations of securities analysts or investors;
- Recommendations by securities analysts or changes in their earnings estimates;
- The announcement or timing of announcement of Brocade's quarterly or annual operating results;
- Announcements of actual or anticipated operating results by Brocade's competitors, Brocade's OEM partners, and other companies in the IT industry;
- Speculation, coverage or sentiment in the media or the investment community about, or actual changes in, Brocade's business, strategic position, competitive position, market share, operations, prospects, future stock price performance, or Brocade's industry in general;
- The announcement of new, planned, or contemplated products; services; commercial relationships; technological innovations; acquisitions; divestitures; or other significant transactions by Brocade or its competitors;
- Brocade's level of success, or perceived level of success, in integrating acquisitions, including the Ruckus acquisition;
- Adverse changes to Brocade's relationships with any of its OEM partners;
- Changes in the business strategy or execution of any of Brocade's OEM partners;



- Departures of key employees;
- Litigation or disputes involving Brocade, Brocade's industry, or both;
- General economic conditions and trends;
- Sales of Brocade's stock by Brocade's officers, directors, or significant stockholders; and
- The timing and amount of dividends and stock repurchases.

In addition, the stock market in general, and the market for technology companies in particular, has experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. Accordingly, broad market and industry factors may adversely affect Brocade's stock price regardless of Brocade's operating performance. In addition, Brocade's stock price might also fluctuate in reaction to events that affect other companies in Brocade's industry even if these events do not directly affect or involve Brocade.

If Brocade's stock price fluctuates widely, Brocade may become the target of securities litigation. Securities litigation could result in substantial costs and divert Brocade's management's attention and resources from Brocade's business.

***Brocade has incurred substantial indebtedness that may decrease its business flexibility and access to capital, and/or increase its borrowing costs, which may adversely affect Brocade's operations and financial results.***

As of July 29, 2017, Brocade had approximately \$1.6 billion in principal amount of outstanding indebtedness, including \$575.0 million of indebtedness under the 2020 Convertible Notes, \$300.0 million of unsecured indebtedness under the 2023 Notes, and \$720.0 million of indebtedness under the Term Loan Facility described below. In connection with the completion of the Ruckus acquisition in May 2016, Brocade entered into the Credit Agreement pursuant to which the Lenders have provided Brocade with a term loan facility of \$800.0 million (the "Term Loan Facility") and a revolving credit facility of \$100.0 million (the "Revolving Facility," and together with the Term Loan Facility, the "Senior Credit Facility") (see Note 8, "Borrowings," of the Notes to Condensed Consolidated Financial Statements in Part I, Item 1 of this Form 10-Q). Brocade's substantially increased indebtedness could have the effect, among other things, of reducing Brocade's flexibility to respond to changing business and economic conditions. In addition, a substantial amount of cash will be required to pay interest, make scheduled principal amortization payments, and repay at maturity Brocade's indebtedness, which may adversely impact Brocade's cash resources, reduce Brocade's business flexibility and reduce the funds otherwise available for working capital, capital expenditures, acquisitions, stock repurchases, and other general corporate purposes. Moreover, Brocade's increased indebtedness may put the company at a competitive disadvantage relative to other companies with lower indebtedness levels.

The Credit Agreement contains financial maintenance covenants, including a maximum total leverage ratio and a minimum interest coverage ratio. The Credit Agreement also contains restrictive covenants that limit, among other things, Brocade's and certain of its subsidiaries' ability to incur additional indebtedness or issue certain preferred equity, pay dividends or make other distributions or other restricted payments (including stock repurchases), sell assets other than on terms specified by the Credit Agreement, amend the terms of certain other indebtedness and organizational documents, create liens on certain assets to secure debt, consolidate, merge, sell or otherwise dispose of all or substantially all of their assets, enter into certain transactions with affiliates, or change their lines of business, fiscal years and accounting practices, in each case, subject to certain exceptions. Brocade and the Lenders have entered into an amendment to the Credit Agreement to provide for additional flexibility in complying with the covenant requiring Brocade to maintain a maximum debt-to-EBITDA ratio for the third and fourth quarters of fiscal year 2017. The indenture governing the 2023 Notes contains several negative covenants that restrict the incurrence of debt by Brocade's subsidiaries, restrict the incurrence of liens on principal properties, and restrict Brocade and its subsidiaries from engaging in certain sale-leaseback transactions. In addition, the indentures governing both the 2020 Convertible Notes and the 2023 Notes impose covenants that restrict Brocade's ability to effect certain mergers, consolidations, or sales of assets and require Brocade to offer to repurchase the notes upon the occurrence of certain "Fundamental Changes" or "Change of Control Triggering Events." A "Change in Control" will also trigger an event of default under the Credit Agreement.

The financial and other covenants agreed to by Brocade in connection with such indebtedness could, among other things, reduce Brocade's flexibility to respond to changing business and economic conditions, increase borrowing costs (if further debt financing is desired), and adversely affect Brocade's operations and financial results. Brocade's failure to comply with these covenants would result in a default under the applicable indenture or the Credit Agreement, which could permit the holders to accelerate such debt or demand payment in exchange for a waiver of such default. A default under one debt instrument could also result in cross-defaults under Brocade's other debt instruments, negatively impact the price and liquidity of Brocade's debt and equity securities, negatively impact Brocade's credit ratings, and impair Brocade's ability to access sources of capital. If any of Brocade's debt is accelerated, Brocade may not have sufficient funds available to repay such debt.

Agencies rating Brocade's debt securities may lower Brocade's credit rating. This could further negatively impact the price and liquidity of Brocade's debt and equity securities and Brocade's ability to access sources of capital. In addition, in the event of certain credit rating downgrades, Brocade's obligations under the Senior Credit Facility, which are currently unsecured, will be required to be secured, subject to certain exceptions, by the equity interests of certain Brocade subsidiaries.

Although interest rates have remained at low levels in recent years, they may increase for various reasons, including an increase in inflation, Federal Reserve Board actions, domestic or international fiscal policies, or domestic or international events impacting financial or capital markets. Higher interest rates or an increase in the credit spread for Brocade's rating could negatively impact Brocade's ability to raise additional debt or refinance existing debt. In addition, the indebtedness under the Senior Credit Facility has a floating interest rate, and an increase in interest rates may negatively impact Brocade's financial results.

***Provisions in Brocade's charter documents, customer agreements, and Delaware law could discourage, delay, or prevent a change of control of Brocade, which could hinder stockholders' ability to receive a premium for Brocade's common stock and adversely affect the value of Brocade's convertible notes.***

Provisions of Brocade's certificate of incorporation and bylaws may discourage, delay, or prevent a merger or mergers that a stockholder may consider favorable. These provisions include, but are not limited to:

- Authorizing the issuance of preferred stock without stockholder approval;
- Prohibiting cumulative voting in the election of directors;
- Limiting who may call special meetings of stockholders and when special meetings of stockholders may be called; and
- Prohibiting stockholder actions by written consent.

Certain provisions of Delaware law also may discourage, delay, or prevent someone from acquiring or merging with Brocade, and Brocade's agreements with certain Brocade customers require that Brocade give prior notice of a change of control and grant certain manufacturing rights following a change of control. Brocade's various change-of-control provisions could prevent or delay a change of control of Brocade, which could hinder stockholders' ability to receive a premium for Brocade's common stock and could adversely affect the value of Brocade's convertible notes.

**Item 6. Exhibits****EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description of Document</b>
2.1	<a href="#"><u>Agreement and Plan of Merger, dated as of November 2, 2016, by and among Brocade Communications Systems, Inc., Broadcom Limited, Broadcom Corporation, and Bobcat Merger Sub, Inc. (incorporated by reference to Exhibit 2.1 from Brocade's current report on Form 8-K filed on November 2, 2016)</u></a>
10.1††	<a href="#"><u>Amendment Number 52, dated June 9, 2017, to Statement of Work Number 1 of the Goods Agreement between IBM and Brocade</u></a>
10.2	<a href="#"><u>Amendment Number 13, dated June 16, 2017, to Statement of Work Number 7 of the Goods Agreement between IBM and Brocade</u></a>
10.3	<a href="#"><u>Amendment No. 1 to Credit Agreement, dated August 11, 2017, among Brocade Communications Systems, Inc., Wells Fargo Bank, National Association, and the other lenders party thereto (incorporated by reference to Exhibit 10.1 from Brocade's current report on Form 8-K filed on August 15, 2017)</u></a>
31.1	<a href="#"><u>Rule 13a-14(a)/15d-14(a) Certification of Principal Executive Officer</u></a>
31.2	<a href="#"><u>Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer</u></a>
32.1	<a href="#"><u>Certification of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u></a>
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
††	Confidential treatment requested as to certain portions, which portions were omitted and filed separately with the Securities and Exchange Commission.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: September 1, 2017

Brocade Communications Systems, Inc.

By: /s/ Daniel W. Fairfax

**Daniel W. Fairfax**

Senior Vice President and Chief Financial Officer